Assigned Risks Pool Review and Successor Practice Definition

Analysis of the responses to the consultations

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Introduction

1. Between 19 November 2009 and 12 February 2010 we consulted on two matters:

A. Various options for a radical change to the Assigned Risks Pool (ARP)

The ARP is the system under which solicitors who are unable to obtain insurance cover on the open market are given temporary cover to enable them to remain in practice.

The compulsory professional indemnity scheme applying to solicitors engaged in private practice work is known as “Qualifying Insurance". Qualifying Insurance is subject to set Minimum Terms and Conditions (MTC) of cover and the insurers who provide this cover are known as “Qualifying Insurers”. Qualifying Insurers have to enter into a Qualifying insurer’s Agreement with us each year through which they agree to issue policies that comply with the MTC and to participate in the ARP.

The ARP has been very successful in terms of ensuring financial protection to solicitors and their clients. However, as identified in the consultation paper, there are two main problems. One is that a number of firms remain in the ARP for significant periods, when it is arguable that it would be better in the public interest and for the profession that they should be closed down promptly. The second is that the cost of the ARP in its current form to the Qualifying Insurers is increasing and is in danger of threatening the continuation of the current arrangements. If the trend continues then the ARP may act as a barrier to new entrants and may force some of the existing Insurers to exit the market.

It has become apparent that the dramatic increase in recent years in the size and consequently the cost of the ARP is putting the scheme under stress and steps are needed to alleviate the pressure. The aim of the review was to identify what action may be necessary to ensure that we can achieve the twin objectives of preserving a system of sound financial protection for clients, and maintaining a sustainable competitive market for solicitors’ compulsory professional indemnity insurance.

B. Changes to the successor practice definition

Anecdotal evidence had highlighted that this definition in the MTC can cause an issue for some solicitors who want to retire and are unable to sell their firms as many other firms are not prepared to run the risk of being classed as a successor practice for professional indemnity insurance purposes. Flexibility in the rule would make it easier for practices to cease in an orderly fashion.

2. The consultations were published on our website. They were drawn to the attention of firms in the ARP and representatives of the Qualifying Insurers through the Liaison Committee (the forum by which we exchange views and discuss indemnity insurance issues with representatives of the Insurers, and the ARP manager). We held meetings with representatives of black and minority ethnic (BME) groups and other representatives whose input we thought would be of interest.

3. This report presents analysis of the feedback we received and the key points made by respondents. In addition to the answers to the questions posed, we have received very useful feedback on the main issues of concern together with a variety of suggested solutions, some of which are helpful and worth exploring further.

Responses

4. We received 130 responses to the ARP review consultation and 39 to the successor practice definition consultation. All of the responses have been considered and we would like to thank everyone who took the time and effort to respond to these consultations. The responses and comments received have been extremely helpful and have provided some very useful feedback. Responses were submitted by, or on behalf of, a range of respondents, including law firms of varying composition and size, and the breakdown of respondents is as follows:

ARP review

Solicitors in private practice		94
Sole principals	32	
Partnerships	23	
LLPs/Ltd Companies	16	
Unknown constitution	18	
Solicitors in employed practice	5	
Representative groups		9
Local law societies		5
Other legal professionals		3
Other regulator		1
Trainees/students		4
Qualifying Insurers		7
Brokers		3
Member of public		2
Other		2
		130

Successor practice definition

Solicitors in private practice		23
Sole principals	6	
Partnerships	4	
LLPs/Ltd Companies	8	
Unknown constitution	5	
Representative groups		3
Local law societies		4
Other regulator		2
Trainees/students		1
Qualifying Insurers		3
Brokers		2
Other		1
		39

For details of some of those who responded see the **Annex.**

A. THE ASSIGNED RISKS POOL REVIEW

5. The consultation paper set out outline proposals for change to the ARP:

- Proposal 1 - cease issuing ARP policies (questions 1 to 4);

- Proposal 2 - new firms will not be eligible to be issued with an ARP policy after 30 September 2010 (question 5);
- Proposal 3 - reduce the maximum period a firm can be in the ARP (question 6).

Question 7 considered the equality and diversity impacts, and question 8 asked for a vote upon which option was most preferred:

- Option 1 - Proposal 1;
- Option 2 - Proposal 2;
- Option 3 - Proposal 3;
- Option 4 - Proposals 2 and 3.

Summary of answers to the ARP review consultation questions

6. We asked eight questions in the consultation. Most of our respondents provided answers to these questions, along with additional comments. Questions 1 to 7 offered a "yes" or "no" option and provided space for further comments. Question 8 asked respondents to vote on their preferred option.

7. In short the results show that:

In respect of proposal 1:

- There was a clear majority against the ARP ceasing to issue ARP policies (question 1) and much concern about the impact this proposal would have on certain firms;
- There was a clear majority in agreement that the existing Qualifying Insurance at the end of the renewal period on 30 September should be extended for one month for firms that had not obtained Qualifying Insurance on the market as at 1 October (question 2);
- There was a clear majority in favour of the previous year's Qualifying Insurer being required to provide the balance of the 6 years' run off cover starting on 1 October, to firms closing without Qualifying Insurance or a successor practice on or after 1 October (question 3);
- There was less of a consensus as to whether the change should be introduced from 1 October 2010, although the majority of respondents were not in favour (question 4).

In respect of proposal 2:

- Respondents were also much less clear as to whether new firms should be eligible to be issued with an ARP policy after 30 September 2010 (question 5);
- Concerns revolved around ensuring the quality of new start-up firms and the barriers that could be caused for the creation of new firms as well as discriminatory issues.

In respect of proposal 3:

- There was very little distinction in the responses as to whether the maximum period a firm can be in the ARP should be reduced (question 6);
- Reservations centered on the timing of the change and payment of premium.

Equality and diversity impacts:

- The majority of respondents were concerned that there would be some adverse impact upon equality and diversity issues (question 7).

The preferred option:

- As to the options, there was no clear choice shown from the responses. 41 respondents abstained from making any clear selection. Of those who did select, a majority (36 of respondents) favoured option 1 (proposal 1, cease issuing ARP policies); 23 respondents were in favour of option 4 (proposals 2 and 3 - new firms not being eligible to be issued with an ARP policy after 30 September 2010 and reducing the maximum period a firm can be in the ARP); and 18 respondents wanted a reduction to the maximum period a firm can be in the ARP.

Proposal 1 – Cease issuing ARP policies

Question 1 - Do you agree that the ARP should cease to provide ARP policies, save to firms already covered by the ARP? (If this measure is introduced on 1 October 2010, firms that are already covered by the ARP as at 30 September 2010 will be able to renew cover with the ARP but only for as long as those firms remain eligible for an ARP policy).

8. 34 respondents answered “yes”; 84 “no”; and 12 abstained. The suggestion that the ARP cease to provide policies raised considerable concerns, particularly as to the impact on sole principal firms, BME firms, and all those “decent” firms which would have been forced to close were it not for the existence of the ARP (for example, firms with a good claims history and no obvious reason for not being able to obtain market insurance). There was also great concern that implementation of this proposal would move the decision as to which firms should continue or not away from the regulator to the insurance market and that loss of the “transitional period” that the ARP currently provides would be very detrimental. (By that we mean the period during which some firms that cannot obtain a market quote in time for the renewal date have to enter the ARP, but which subsequently receive a market quote and so are able to leave the ARP).

9. The reasoning of those respondents in favour of the ARP ceasing to provide policies was based on the expense of the ARP to the whole profession and the Qualifying Insurers and the risk that is perceived is posed by most firms in the ARP. Some respondents suggested that the single renewal date should be removed. Others felt that there should be complete closure of the ARP to all firms, or that there are other solutions other than a wholesale abolition of the ARP (such as alternative or reduced MTC or an extended Compensation Fund – the fund which exists to replace client money which a defaulting solicitor has misappropriated or otherwise failed to account for). It was also felt that that there could be greater assistance provided to firms in order to assist them in obtaining Qualifying Insurance and better regulation of firms.

10. Comments from respondents who were not in favour of the ARP ceasing to provide ARP policies included:

- “many firms found themselves in the ARP through no fault of their own and it is unfair for Qualifying Insurers to decide who closes or not”;
- “the ARP is a lifeline to BME firms”;
- “the ARP ……provides a number of important consumer protection functions”;
- “scrapping the ARP is like throwing the baby away with the bath water.”

11. Comments from respondents who were in favour of the ARP ceasing to provide policies included:

- "the ARP only postpones the inevitable in most cases at great expense to the Qualifying Insurers and ultimately to the profession as a whole";
- "why should failing solicitors have any special protection from their more efficient competitors";
- "the ARP should not be available for firms that present such a risk level that they can't get commercial cover";
- "the original aims (of the ARP) to protect the public whilst assisting distressed firms with rehabilitation have failed".

12. The Law Society was not in favour of ceasing the ARP which it regards as "an important link in the chain of public protection". It had concerns about our ability to intervene into what could be a large number of affected firms all at the same time and suggested that a cheaper alternative to intervention would need to be developed. The BME group representatives that responded were not in favour of ceasing the ARP.

Question 2 - Do you agree that the Qualifying Insurance in existence as at 30 September should be extended for one month for firms that have not obtained Qualifying Insurance in the market as at 1 October?

13. There was a very clear majority in response to this question with 84 respondents answering "yes"; 31 "no" (although 8 of these were saying no to the extension of one month rather than the principle itself and were proposing that a longer period of extension was more appropriate); and 15 abstaining. There was concern about the responsibility for premium payment and the potential for this to be unpaid.

14. Comments from respondents who were in support of the existing Qualifying Insurance at 30 September being extended included:

- "this is a sensible and proportionate response to those firms who through exceptional circumstances are unable to have cover in place";
- "…..subject to payment of clear funds ……."

15. Comments from respondents who were not in support included:

- "those that leave it to the last minute only have themselves to blame";
- "would simply lead to an effective renewal date of 31 October."

Those respondents who answered "no" because they disagree with the length of the extension suggested a variety of longer periods from three to twelve months.

Question 3 - Do you agree that if the firm fails to effect Qualifying Insurance, or closes without successor practice, on or after 1 October, the previous year's Qualifying Insurer would be required to provide the balance of the 6 years' run off cover starting on that 1 October?

16. There was a clear majority in response to this question with 80 respondents answering "yes"; 31 "no"; and 19 abstaining. There was concern again about responsibility for payment of the premium and the problems that could be caused for Qualifying Insurers. Some respondents suggested the establishment of a separate body or fund to provide run-off cover with a separate premium.

17. Comments from respondents who were in agreement included:

- "….allows Qualifying Insurers to correctly price the run-off exposure";
- "but only at the expense of the firm".

18. Comments from respondents who disagreed included:

- "this would stigmatise new and small firms who will ……face disproportionate loading (of their premium):
- "even more questions will be asked on renewal";
- "the costs would fall to be met ultimately by the rest of the profession".

Question 4 - Do you agree that the change should be introduced with effect from 1 October 2010?

19. There was less of a split in the responses to this question with 52 respondents answering "yes"; 62 "no"; and 16 abstaining. There was concern that the proposed implementation date of 1 October 2010 was too short notice (the preference was from 1 October 2011) and did not provide sufficient time for firms to adjust to the change. There was also concern that a full equality impact assessment should have been undertaken first as to the effects of instigating proposal 1.

20. Fewer comments were made in response to this question. Feedback from respondents who were in agreement included wanting to see an appropriate mechanism to ensure that Qualifying Insurers do not unreasonably refuse cover. Comments from respondents who were not in agreement included the view that we are not addressing the issue of the inability of ARP firms to get Qualifying Insurance.

Our response to proposal 1:
The ARP to cease to provide ARP policies, save to firms already covered by the ARP

21. It is clear from the full equality impact assessment that has been carried out, the meetings with stakeholders and the analysis of the consultation responses, that abolishing the ARP from 1 October 2010 is not a viable or desirable option. We have decided to retain the ARP (in a modified form as set out later). The key factors against proposal 1 are:

- It would have a disproportionate effect on BME firms and potentially adverse impacts for race and age equality. Widespread closure of small firms would raise issues of access to justice and would be detrimental to the public interest;
- It would place insurers in the position of determining who should practice or not (something insurers themselves do not want).This is properly our role as regulator;
- The burden of the costs of the ARP would be transferred from a pool of insurers, to individual insurers. Insurers of small firms would lose out substantially so presenting a high risk that these insurers would pull out of this segment of the market. This could leave a very large number of firms that could be forced to close because of the unavailability of Qualifying Insurance;
- Closing the ARP would not address the real reasons for high claims emanating from firms in the ARP. Those reasons include some lack currently of effective regulatory mechanisms to enable us to deal with individuals and firms from entry into, through to exit from, the profession;
- There are a wide range of alternative proposals that could significantly reduce the cost of the ARP without a wholesale abolition of it.

Proposal 2 – New firms will not be eligible to be issued with an ARP policy after 30 September 2010

Question 5 - Do you agree that new firms should not be eligible to be issued with an ARP policy with effect from 1 October 2010?

22. There was no overall majority response with 65 respondents answering "yes"; 51 "no"; and 14 abstaining. There was some concern about the quality of new start-up firms. Other respondents were concerned that this proposal would present a barrier to the creation of new firms and could be anti competitive as well as discriminatory to small, and especially, BME firms.

23. Comments from respondents who were in agreement with the proposal included:

- "new firms should operate in a risk averse manner from day one so that Insurers have no grounds to decline;"
- "it is unacceptable for new firms to use the insurer of last resort. If they can't get Qualifying Insurance they should not be allowed to operate";
- "given how expensive the ARP is it seems unlikely that a new firm that has to rely on it from them outset could constitute a long term business."

24. Comments from respondents who disagreed included:

- "the fact that firms can't get Qualifying Insurance may be a due to prejudices and misconceptions…..rather than a reflection on the firm's quality or viability";
- "this hands a huge amount of power to Insurers and will almost certainly drive up premiums";
- "new firms should be given a chance and sometimes need help."

25. Both the Law Society and the BME group representatives had reservations about introducing the change from 2010.

Our response to proposal 2:
New firms not eligible for an ARP policy after 30 September 2010

26. Most stakeholders broadly support proposal 2 and this change will be implemented. We considered the points made regarding timing but have taken the view that any change should be implemented from 1 October 2010. A "new firm" will include a new start up not previously connected to any other firm – for example an assistant solicitor deciding to set up in practice as a sole practitioner; a firm resulting from a breakaway or split from an existing practice in circumstances where the firm is not a Successor Practice; and a practice that has been regulated by another regulator and is applying to be regulated by us. The definition of an "eligible firm" in the Solicitors' Indemnity Insurance Rules will be changed from 1 October 2010 so that eligibility for the ARP is confined to firms who have obtained Qualifying Insurance in the open market in the past. Transitional provisions will cater for firms that are already in the ARP at 1 October 2010.

27. We are considering the support and advice we can give to solicitors proposing to set up a new firm and reviewing our criteria for recognition of new firms.

Proposal 3 – Reducing the maximum period a firm can be in the ARP

Question 6 - Do you agree that the maximum period a firm can be covered by the ARP should be reduced from 24 months to 12 months with effect from 1 October 2010?

28. There was no clear preference. 54 respondents replied "yes", 58 "no" and 18 abstained. There was some support for a reduction to an even shorter eligibility period of six months. Others suggested the eligibility period should be extended to three or five years. There was some disagreement about retaining our discretion to extend the time of eligibility and there were reservations again about introducing the change in 2010 (2011 was seen as preferable).

29. Comments from respondents who agreed included:

- "there is no benefit to an extended period in the ARP";
- "the present system is being abused";
- "… but management of firms in the ARP needs to be rigorous."

30. Comments from respondents who disagreed included:

- "the safety net needs to remain";
- "this will force many firms, whose only fault is being unable to find affordable Insurance, to close. With prohibitive run off cover, firms will be forced into bankruptcy. What a desperately sad way to end a lifetime of practice".

31. The Law Society was in support of a reduction but for a period of between six and twelve months. The BME group representative that responded was against this proposal.

Our response to proposal 3:
Reducing the maximum period a firm can be in the ARP

32. This change received widespread support and will be implemented. Again, we considered the points made regarding timing but have taken the view that the change should be implemented from 1 October 2010. Transitional provisions for those firms that are already in their first year in the ARP as at 30 September 2010 will uphold their legitimate expectation of a second year's cover until 30 September 2011. We will retain the power to allow a firm to remain in the ARP beyond the maximum period in very exceptional circumstances. As there is potential for adverse impact for race equality we will adopt fair and objective criteria for exercising this discretion.

Equality and diversity

Question 7 - What equality and diversity impacts do you believe the proposed changes will have?

33. Most respondents believed that there would be negative impacts upon equality and diversity issues with 68 responding "yes" to the question, 44 "no" and 18 abstaining. There were clear concerns that the changes could impact significantly upon sole principal, small and BME firms, "high street" firms, those with low turnover or operated on a part time basis, those with a certain work type such as immigration, or firms in a particular geographical location (certain postcodes, areas where fee income is much lower and local rural communities). Age discrimination was a concern too. Feedback showed unease about some of the questions on Insurers' proposal forms, such as

asking about the place of study or qualification. Some respondents however believed that there was an over emphasis upon equality and diversity and that there was no link between entry into the ARP and ethnicity. The majority of Insurers who responded to the consultation did not believe that they were discriminatory in any way.

34. Comments from respondents who believed there would be an adverse impact included:

- "it will discourage new entrants to the market, adversely affect competition and reduce client choice";
- "independence of firms is being questioned";
- "……on BME firms serving their community in a very niche practice…..will mean higher fees for that community and hinder further access to justice and legal advice."

35. Comments from respondents who did not believe that there would be an impact included:

- "the ARP is a subsidy from good firms to those with poor records – why should that be justified on E and D grounds?"
- "… should be no impact for firms that are conducted competently and in compliance with regulations";
- "none as long as Qualifying Insurers operate in affair and transparent manner and with complete respect for E and D".

The Law Society believed that there would be a disproportionate impact upon BME firms. The BME group representatives that responded reflected the disquiet amongst BME firms who felt trapped and that the independence of their firms was being questioned. They felt that there would be a disproportionately adverse effect upon BME firms with harsh consequences.

Our response to equality and diversity issues

36. The statistics and evidence gathered through meetings with BME groups and other stakeholders suggests that all of the three proposals have the potential to have direct or indirect adverse impact on race equality and, to a lesser extent, age equality. We have conducted a full equality impact assessment.

37. We have written to all the Qualifying Insurers asking them certain questions in the context of this review, such as information about any equality policy they may have and about any procedures in place to show that they are not indirectly discriminating on racial grounds against customers or potential customers. Whilst it is clear from the direct responses, and the response of the Association of British Insurers on behalf of other Insurers, that they are aware of the need for equality, we feel that there is much more work that we can do with the Insurers, in consultation with their regulator the Financial Services Authority, to promote better awareness and a deeper understanding of how to guard against discrimination.

The options

Question 8 – Which of the following options do you prefer most?

38. Around two thirds of respondents chose an option. The remainder did not, or did not clearly do so, and some of the choices selected, or abstentions, were at odds with the respondent's answers to the earlier questions. 36 respondents chose option 1

(proposal 1, to cease issuing ARP policies), 8 chose option 2 (proposal 2, that new firms will not be eligible to be issued with an ARP policy after 1 October 2010), 18 chose option 3 (proposal 3, to reduce the maximum period a firm can be in the ARP), 23 chose option 4 (a combination of proposals 2 and 3). 41 respondents abstained (four of which felt that the system should be left as it is and another that none of the proposals were favourable in any way). Two respondents voted for all of the proposals to be implemented and one respondent for a combination of options 1 and 4. An entirely clear view based upon a "vote" in question 8 alone therefore is difficult.

39. The Law Society chose option 4. The BME group representatives that responded made no clear choice.

Our response to the options voted for

40. Having considered the feedback from the consultation and the full equality impact assessment, and taking into account the strong arguments received in support of keeping the ARP, on 4 May our Board decided to retain the ARP in a modified form. The changes to the ARP have been set out in our responses above, namely to reduce the length of time a firm can remain in the ARP from 24 to 12 months, and to not allow new firms to be eligible to enter the ARP.

Other general feedback

41. The fixed renewal date of 1 October was thought to be problematic by a number of respondents who believe that a variable renewal date would allow for a more orderly renewal, give more time and opportunity for proper consideration of the proposal forms and allow proper underwriting of the risks presented, so creating a more competitive market. The perception in some cases is that Qualifying Insurers only start considering proposal forms in late August, which produces a renewal "bottleneck" by 30 September. It was suggested that Insurers should start to quote much earlier and that firms should be able to apply for, and obtain cover, throughout the year.

42. More effective and rigorous management of firms was a common thread with the feeling that we should close sooner those posing an unacceptable risk and give more suitable assistance to those that can be rehabilitated. Suggestions included improved regulatory action, particularly around entry into the profession, inspections of ARP firms to be done within 8 weeks of entry into the ARP and a capital requirement on new firms.

43. Some respondents felt that we are not addressing the issue of the inability of ARP firms to get market Insurance. Suggestions ranged widely from us conducting an analysis of why firms fall into the ARP in the first place and better liaison between us, the Law Society and Insurers, to establishing an independent body to judge and set the level of ARP premium which should be commensurate with the ability to pay. Other ideas varied from imposing an obligation on Qualifying Insurers to give reasons for their refusal of cover or a mechanism to oversee these decisions, to capping the premium they can charge at a percentage of a firm's gross fees.

Our response to general feedback comments

44. We have considered previously the question of a variable renewal date. In the past, the powerful argument against a variable renewal date was the concentration of competition at one particular point which has worked to the benefit of the profession (as demonstrated by the Qualifying Insurers' premium income figures). We are continuing to keep this under close review particularly in light of the introduction of other ways of

practising with the approach of alternative business structures.

45. Currently monitoring visits of ARP firms do not start until three months after the renewal date (in January) because in October and November Qualifying Insurers can backdate their cover for 60 days to start on 1 October, in which case the firm can leave the ARP. During the rest of the year cover can only be backdated by 30 days. Monitoring visits are not carried out in the first 2 months of an indemnity period as, until 1 December, it is not certain that any particular firm will have been in the ARP. The intervening Christmas period means that visits do not start until January. The backdating provision will be changed from 1 October 2010 to a period of 30 days at any time of the year, so speeding up the start of the visits to ARP firms.

46. We have conducted analyses of the make up of ARP firms (as at February 2010): most are small; 39% already had a claim outstanding; 41% have a BME majority make-up; the largest areas of work are immigration and residential conveyancing; and the largest concentration of firms is within the East and South East London. We have conducted a survey too to look at why firms went into the ARP. There was a limited response to this and little clear information as to why firms in the ARP were unable to obtain market insurance. Reasons given included an outstanding claim or complaint, the nature of the work undertaken by the firm, it's small or low turnover, an excessive market quote, and perceived racial discrimination. Our findings are set out in full in the appendices to the full equality impact assessment.

B. THE SUCCESSOR PRACTICE DEFINITION CONSULTATION

50. The consultation paper proposed a change whereby if one firm (firm A) is acquired by another (firm B) such that firm B falls within the definition of a "successor practice" in the Minimum Terms and Conditions, that within a short period firm A could opt to elect to trigger run-off under its policy of Qualifying Insurance. All subsequent claims made against firm A would then be dealt with under the run-off cover and the successor practice, firm B, and its Insurer, would not be liable for future claims.

Answers to the successor practice definition consultation questions

51. We asked four questions. Most of our respondents provided answers to these questions, along with additional comments. All of the questions offered a "yes" or "no" option and provided space for further comments.

52. In summary the results show that:

- There was a clear majority that believed the definition is causing significant problems for firms that wish to cease practice (question 1);
- A clear majority was in favour of introducing flexibility into the definition of "successor practice" (question 2);
- Most respondents were in favour of the proposed amendment to the definition of successor practice (question 3); and
- Most respondents did not foresee any adverse equality and diversity impacts from the proposed change (question 4).

Question 1 – do you believe that the definition of successor practice is causing significant problems for firms that wish to cease to practice?

53. Responses clearly showed that it is believed that the definition can create confusion and uncertainty with 30 respondents answering “yes”; 4 “no”; and 5 abstaining, and it was evident from some of the responses themselves that there was misunderstanding of the application and affect of the definition. There was concern that in some cases it is almost impossible to conduct a comprehensive due diligence exercise on a firm being acquired, meaning that if there was subsequently a serious issue the successor practice could be financially ruined for something it had no control over. The current rule was thought too to be unsatisfactory for Insurers who have problems recovering premiums and in the accurate matching of premium to risk, and it can also lead to policy disputes between Insurers and firms. One respondent believed that the rule caused no problem for those firms that organise their practice and exit properly.

54. Comments included:

- “the main issue is the potential to become a successor without intention….makes it difficult for firms to make decisions”;
- “ring fencing claims would be a real benefit”;
- “it is impossible for the owners of the ceasing firm to work in any capacity for the firm buying its clients in order to provide a good hand over.”

55. The Law Society felt that the current rule is difficult to construe and needs clarification, and that it deters firms from merging with, or acquiring, another firm.

Question 2 – Are you in favour of introducing flexibility into the definition of “successor practice”? Please give reasons in support of your answer.

56. 32 respondents answered “yes”; 5 “no”; and 2 abstained. Most thought that some way needs to be found to enable another practice to take over a closed firm without its insurance liabilities and to provide a route for firms to close in an orderly manner. The application of the definition could sometimes produce an irrational and unpredictable outcome. Those who answered no did so because they felt the amendment would be unfavourable to good business practice, administratively complicated and that to allow a firm to take over the assets and goodwill of another firm without accepting any liabilities would be contrary.

57. Comments included:

- “it provides complete security for the successor practice”;
- “it will give greater freedom of choice and to firms to make their own arrangements”;
- “the proposal encourages unprofessional practice”;
- “If an entity appears out of the ashes of the former firm but free form its liabilities there is much public disapproval and the reputation of the profession will be tarnished”;
- “Flexibility leads to uncertainty.

58. The Law Society response was that the current definition acts as a barrier to mergers and acquisitions which is detrimental to firms and clients. It believed the change would facilitate the orderly closure of firms and help lower the number of firms in the ARP.

Question 3 – Are you in favour of the proposed amendment to the definition of successor practice?

59. 26 respondents answered "yes"; 8 "no"; and 5 abstained. There were reservations that the change was premature until the introduction of alternative business structures, about the definition of "cessation", and about payment of the run off premium. The proposed period of grace was seen to lead to uncertainty especially if a claim arose during that time.

60. Comments included:

- "it is important that solicitors from different firms are able to help one another when necessary without fear of redress or of being considered a successor practice";
- "a residual risk of undiscovered liabilities after due diligence is a normal part of the entrepreneurial risk associated with all takeovers and all commercial decisions";
- "the change creates an opportunity for bad firms to leave behind their liabilities".

61. The Law Society felt that the ceasing firm should be required to elect prior to the merger or acquisition, but not within 30 days. It proposed that all firms should have the option of buying run off cover upon cessation, but that it would have to be in place and paid for as at the date of cessation, merger or acquisition (or otherwise the current successor practice provisions should apply).

Question 4 – Do you foresee that the proposed change will have any adverse equality and diversity impacts?

62. 29 respondents answered "no"; 2 "yes"; and 8 abstained. Most respondents, including the Law Society, believed that there would be a positive impact on BME firms.

Our response to the Successor Practice definition responses

63. We have decided to implement the changes to the successor practice rule, subject to abandoning the proposed 30 day election period. We concluded that it would be better not to have a period of grace in which to make an election as it increases uncertainty. The change will allow firms to elect to trigger run-off cover with their existing Insurer or with another Insurer. The existing Insurer cannot refuse to accept an election. There will be an obligation on firms to report the succession cover election to us within 7 days and an obligation to pay the run-off premium before the election becomes effective.

Conclusions and future action in response to both consultations

64. It is accepted by most stakeholders that a change to the ARP is necessary now in order to sustain a vibrant and competitive market of Qualifying Insurance, and that the ARP is no longer working as it was first envisaged it should. The introduction too of flexibility in the successor practice rule will help to facilitate orderly closure and handover and, in some cases, allow for the movement of sole principals into a "phased" retirement, perhaps through a consultancy with another firm. We have set out the changes in the body of this report, with an explanation of our thinking, but to summarise:

- The ARP will be retained;
- 'New firms' will not be eligible to be issued with an ARP policy with effect from 1 October 2010;

- The maximum period a firm be covered by the ARP will be reduced from 24 months to 12 months with effect from 1 October 2010;
- The rules relating to 'Successor Practice' contained in the MTC will be amended to allow a firm that is to cease by way of a succession to elect to trigger run-off cover.

65. The biggest issue for us to tackle is the identification and management of poorly performing firms as closing the "hospital" does nothing to treat the "disease". The major criticism of the current system is that nothing is done until the patient turns up in accident and emergency, and even then the exercise is largely one of monitoring rather than active treatment. We are proposing to put in place an initiative to manage down the risk of unstable firms, and so address some of the root causes of the problem including:

- trying to prevent firms with unstable business models from being recognised in the first place;
- risk indicators for firms in trouble;
- improved support (not necessarily from us) for firms in trouble, either to rescue them or manage them down with minimum damage.

66. We will consider what further action is required to address the underlying problems with the ARP. Future work will concentrate first on the steps to be taken to reduce the risks that lead to the claims in the first place.

67. In response to the challenges posed by a dramatic increase in the size of the ARP over recent years, we have recently adopted a more flexible and proportionate strategy for monitoring firms in the ARP and where possible, supporting their efforts to get back into the open market. Firms will have a response that is appropriate to the risks posed: a softer touch for the firms posing a lower risk will allow us to focus on firms which are likely to generate more claims and where appropriate, to close them down sooner.

68. We are considering how we can provide advice and improve support to solicitors who wish to establish new firms. There may be scope for others to offer such advice, for example, by way of events and seminars on running a business. The Law Society has a round of seminars planned from June to October for existing firms and new start ups covering a range of areas such as information technology and finance. We are reviewing the criteria for recognition of a new firm which perhaps should include some consideration of the firm's business plan and financial viability.

69. We will set up a forum with representatives of BME firms, and the Insurers to discuss the equality and diversity issues of concern and to take forward the actions identified in schedule 13 to the equality impact assessment

Annex

Respondents

This list includes only those who have agreed to their names appearing in a list of respondents for publication

Respondents to the ARP review consultation

- Anthony Harris & Co
- Arch Solicitors
- Aslam Mazhar
- Association of British Insurers
- Barry and Blott
- Beachcroft LLP
- Beale & Co Solicitors LLP
- Bernard Cordell
- Birmingham Law Society
- Black Minority Ethnic Forum check ok
- Black Solicitors Network
- British Insurance Brokers Association
- Cambridgeshire Law Society
- D Cameron
- Christopher Mathew Solicitors
- Conninghams
- Crowther solicitors
- Equality and Diversity Committee of the Law Society check ok
- Girasol Services
- Hampshire Incorporated Law Society
- K Hathaway
- Henmans LLP
- ILEX Professional Standards Ltd
- KSRI Solicitors
- Laura Garcia
- The Law Society
- Legal Services Consumer's Panel
- Libra Managers (agents of Barbican Syndicate 1955)
- Lincoln Solicitors
- Linklaters LLP
- Macrory Ward
- Mandy Peters Solicitors
- Nathaniel
- O Omatusli
- Professions UK Ltd
- RHY Law LLP
- Ravals Legal Serivce
- Red Law Solicitors
- Samuel Ross Solicitors
- The Sole Practitioners Group
- Stainforth Solicitors
- The Contracts Team Ltd
- Three Clear Solutions Ltd

- Van Arkadie & Co Solicitors
- Vincent Sykes & Higham LLP
- QBE (Insurance) Europe ltd
- Quinn Insurance
- Zurich Professional & Financial Lines

Respondents to the successor practice definition consultation

- The Law Society
- Association of British Insurers
- Barry & Blott
- Beachcroft LLP
- Birmingham Law Society
- Black Minority Ethnic Forum
- Black Solicitors Network
- British Insurance Brokers Association
- City of Westminster and Holborn Law Society
- Hampshire Law Society
- Harvey Cohen
- Henmans LLP
- ILEX Professional Standards Ltd
- Legal Complaints Service
- Legal Risk LLP
- Munich Re UK General Branch's
- N D Clifford
- Professional UK Ltd
- Solicitors First LLP
- The Law Society Property Section Executive
- The Law Society
- Zurich Professional and Financial Lines