

Assigned Risks Pool review

Consultation paper

19 November 2009

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1. Introduction

Purpose of this paper

- 1.1 This paper seeks the views of consumers, the legal profession, insurers, and the public on options for radical changes to the Solicitors Regulation Authority's Assigned Risks Pool ("ARP") – 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. Views are sought by 12 February 2010.
- 1.2 The fundamental principles against which this review has been conducted have been that any reforms to the ARP must:
 - a. Maintain or enhance the protection given to solicitors' clients;
 - b. Minimise the costs to insurers and the profession – costs which are ultimately borne by the consumers of legal services;
 - c. Be fair to the profession.

Background

- 1.3 The SRA's Financial Protection Committee ("the Committee") is conducting a fundamental review of the ARP with a view to effecting any changes for the 2010/11 renewal.
- 1.4 Professional indemnity insurance for solicitors in private practice has been compulsory since 1976. Its primary purpose is to provide financial protection to clients in circumstances where they have suffered a loss due to the acts or omissions of their solicitors.
- 1.5 The current market-based compulsory professional indemnity insurance scheme was introduced in 2000. It is a scheme which provides a high degree of protection to the public and profession at a comparatively low cost overall. Public protection is provided by having very broad coverage, no limit on the number of claims, and a minimum sum insured of £2 million any one claim (£3 million in the case of limited companies and Limited Liability Partnerships (LLPs)). Insurers cannot avoid a claim or cancel a policy because of alleged misrepresentation or non-disclosure by a firm, for example in a proposal form. The profession as a whole has benefited from low premiums compared with the contributions payable in the final years of the Solicitors Indemnity Fund (SIF) (described in more detail at paragraph 1.10 below) and the minimum sum insured has doubled, or, in the case of limited companies and LLPs, tripled. In contrast, since the move away from SIF the gross fees of the profession have more than doubled.
- 1.6 The ARP was established as an integral part of the current scheme and is underwritten by all the Qualifying Insurers to provide insurance for those firms that have been unable to obtain cover in the open market. The Qualifying

Insurers have voiced concerns at the increasing cost of the ARP that they have to bear under the terms of the Qualifying Insurer's Agreement and the lack of control they have in relation to their ARP exposure. In 2008/09 98.5% of firms were able to secure Qualifying Insurance in the market with 1.5% covered through the ARP. However, the small percentage of firms in the ARP cost a huge amount of money and the position is getting worse. In 2007/08 there were 28 firms in the ARP which rose to 150 in 2008/09. In the current year 2009/10 indications are that there will be around 300 firms. There is a concern that the ARP entitles high-risk firms to continue in practice when it would be better that they were closed. Loss ratios (that is the ratio of value of claims incurred to the value of premium income received) for the last nine years is currently running at close to 600% necessitating regular cash calls on the Qualifying Insurers. To date the cash calls on the Qualifying Insurers for all years since 2000 have totalled £28 million. The ARP premium rates are very high as are the default rates.

- 1.7 In more recent years the number of firms that have derived long term benefit from being in the ARP is very low. Looking at the four years from 2004/05 to 2007/08, only nine firms that were insured by the ARP at the end of each of the relevant periods subsequently obtained market cover and continued in practice.
- 1.8 From the profession's point of view there is concern that the costs of the ARP are passed on to the profession through higher premiums, and that too many firms are surviving because of the ARP, when they should in fact have closed. Clients are more likely to have cause to make a claim against a bad firm and so are disadvantaged even if the ARP provides the same degree of public protection as Qualifying Insurance provided by a market insurer. It will also impact clients to the extent that the additional cost of the ARP may ultimately be passed on to clients in the form of higher fees.
- 1.9 The Committee recognises that the ARP is putting a very good scheme under stress and urgent steps need to be taken to alleviate the pressure. In undertaking this review the Committee has the twin objectives of preserving client financial protection and maintaining a sustainable competitive market for solicitors' compulsory professional indemnity insurance. The consequence of preserving client financial protection is that the consultation is as much about who bears the cost of protecting clients as it is about reducing that cost.

Purpose of the ARP

- 1.10 From 1987 to 31 August 2000 the compulsory professional indemnity scheme for solicitors was provided by means of a statutory fund called the Solicitors Indemnity Fund (SIF). SIF provided cover to all firms in private practice regardless of their claims history, the type of work they were engaged in and their SIF payment record. Contributions were set by Rules that took into account various underwriting factors including gross fees, type of work and claims history. As SIF provided cover to all firms it also provided run-off cover unlimited by time to any ceasing practice at no direct additional cost at the point of cessation.
- 1.11 For various reasons the profession lost confidence in the SIF arrangement and, following a ballot of the profession which decisively opted for freedom of

choice, the Law Society Council (“the Council”) decided to replace the Fund with a scheme relying wholly on the commercial market. The current scheme based on Qualifying Insurers came into effect on 1 September 2000.

- 1.12 When setting up the current arrangements there were some important features of the SIF arrangements which the Council wished to preserve including:
- (i) The decision whether a firm should continue in practice should be that of the regulator, not the insurance market.
 - (ii) The scheme should provide public protection even when a firm has failed to effect compulsory professional indemnity insurance.
 - (iii) There should be automatic run-off cover in respect of ceased practices.
 - (iv) The breadth of cover should be as wide as that provided by SIF.
 - (v) Cover should be for all civil liability arising from private legal practice, with only limited permitted exclusions.
 - (vi) Cover should not be voidable for non-disclosure, misrepresentation or failure to pay premium (although insurers may have rights of reimbursement against insureds).
- 1.13 By providing policies of Qualifying Insurance the ARP maintains client protection by acting as a safety net for a limited period for any firms that cannot obtain Qualifying Insurance in the open market. It also provides an opportunity for the SRA to assess the risk posed by each ARP firm and to take appropriate regulatory action where necessary. In this way the decision whether a firm should continue in practice rests with the SRA as regulator rather than with the insurers.
- 1.14 The cover provided by the ARP meets the Minimum Terms and Conditions of cover that all policies of Qualifying Insurance must satisfy, so there is no impact in terms of public protection.
- 1.15 Where a firm practises without Qualifying Insurance from either the market or the ARP, public protection is provided by a separate “side arrangement” with the Qualifying Insurers similar to the ARP under which the Law Society (in practice the SRA acting as the regulatory arm) is the insured. It is similar to the Motor Insurers Bureau which provides cover in respect of uninsured drivers.
- 1.16 The ARP also plays a role in protecting the public whilst disputes between insurers are resolved. Where the parties to a dispute cannot agree who should handle a claim, the Qualifying Insurer’s Agreement provides that the ARP Manager shall conduct the claim, advance defence costs and, if appropriate, compromise and pay any such claim in the normal course on behalf of each relevant Qualifying Insurer. Once the dispute is resolved through arbitration then the relevant Insurer is required to promptly reimburse the ARP Manager all of the costs and expenses it has incurred in the conduct of the claim together with interest.

Run-off cover

- 1.17 It is important to note that in England and Wales, professional indemnity policies are generally written on a “claims made” basis rather than a “losses occurring” basis. This means that responsibility for paying a claim lies with the insurer at the time the claim is first made, or circumstances which may give rise to a claim are notified, rather than with the insurer that was on cover when the alleged negligent act took place. This is a very important distinction between professional indemnity insurance and many other forms of insurance. It also means that, in order to maintain public protection, when a firm ceases it is necessary for run-off cover to be in place to cover claims that are made after the firm has closed.
- 1.18 Under the current arrangements if a firm closes without successor practice then the Qualifying Insurer (or ARP) on risk at the date of closure is required to provide cover for the balance of the indemnity year and for a further 6 years thereafter. If a firm closes due to a succession by a successor practice then any future claims arising from the ceased firm will be covered by the Qualifying Insurer (or ARP) on risk for the successor practice at the date the claim is made.

How the ARP works in practice

ARP Manager

- 1.19 The ARP is managed by a manager appointed by the SRA. The current ARP Manager is Capita Commercial Insurance Services Limited. It was reappointed for a further three years from 1 October 2007 following a tender process. The functions of the ARP Manager include the following:
- To process applications to enter the ARP and to issue ARP policies.
 - To administer renewals and cancellations of ARP policies.
 - To determine premiums payable by each ARP firm in accordance with the rules.
 - To calculate and adjust each insurer's initial participation, percentage participation and percentage liability.
 - To receive notice of claims and to negotiate, settle and pay claims on behalf of all insurers participating in the ARP.
 - To provide data to the SRA relating to ARP policies and ARP firms in default covered by the ARP.
 - To collect debts due to the ARP. If necessary, this will involve issuing a Statutory Demand followed by bankruptcy proceedings.

Applying to enter the ARP

- 1.20 All firms are eligible to be in the ARP other than firms that have been in the ARP for 24 months or more in the previous four indemnity periods and firms

that are in Policy Default (that is are more than two months in arrears with payment of any sum due in respect of a Policy of Qualifying Insurance including an ARP Policy).

- 1.21 Firms can apply to the ARP by submitting a completed application form to the ARP Manager. The Manager checks that the firm is eligible to be in the ARP and then calculates the premium due using the rating schedule set out in Appendix 2 to the Solicitors' Indemnity Insurance Rules. Premiums to the pool are set through a prescribed sliding scale up to 27.5% of gross fees for the smallest firms. This provides premiums which are broadly equivalent to the maximum which firms with poor claims records might have paid to the Solicitors Indemnity Fund.
- 1.22 Firms can opt to pay their ARP premium by instalments through a loan facility provided by Premium Credit.

ARP firms

- 1.23 Firms are allowed to stay in the pool for a maximum of 24 months. If they cannot obtain cover in the commercial market by then, they will have to close or obtain an extension. There are only very limited circumstances in which the SRA will extend the maximum period in the ARP, or will grant waivers of the premium required.
- 1.24 Firms in the ARP may be subject to monitoring visits by the SRA. Decisions as to whether to visit a particular firm and the type of visit are based on risk profiling using all available information held or obtained by the SRA. Firms may receive an ARP monitoring visit carried out by the Forensic Investigations Team of the SRA's Investigation Unit. The visiting officer assesses the risks posed by the relevant firm and then prepares a visit report with suggested special measures. The report is submitted to the Head of Professional Indemnity and Client Protection Policy for a decision as to the special measures to be imposed. The special measures relate to improving practice management, and may cover such matters as adopting the Law Society's Practice Management Standards, or ensuring that a particular area of work is properly supervised. The cost of an ARP monitoring visit is met by the relevant firm.
- 1.25 Qualifying Insurers are required to participate in the ARP in proportion to their share of the market for mandatory insurance by reference to premium income. Each Qualifying Insurer bears its due proportion of the ARP losses. In order to calculate the due proportions, each Qualifying Insurer is required to declare the total premium it has written for the compulsory layer of cover. The ARP Manager then calculates the relevant percentage shares for that indemnity period. If there is a shortage of funds in respect of a particular indemnity period then the ARP will make a cash call and each of the relevant Qualifying Insurers is required to pay its due proportion.
- 1.26 Claims against ARP firms are handled internally by the ARP Manager. External legal advice may be needed on a particular matter of law or on one specific aspect of a claim such as causation or quantum. Outside lawyers are instructed to represent firms insured by the ARP in litigation against those firms.

Non-applied firms

1.27 From time to time firms escape the notice of the SRA, and carry on practice without proper regulation, for example without the Principals having Practising Certificates, and without the firm having effected Qualifying Insurance, either with a Qualifying Insurer or with the ARP. When these Firms come to the attention of the SRA, appropriate regulatory action is taken against them and their Principals. Any claims against them are covered by the "side arrangement" referred to in paragraph 1.15, so clients are as well protected as if proper insurance had been effected. Because these firms do not have insurance in the commercial market, and have not applied to the ARP, they are referred to as "non-applied firms". They are each required to pay a sum equivalent to the ARP Default Premium, which is calculated as 120% of the ARP Premium. Because of the nature of these firms, and because when their activities are discovered many are closed by intervention, little if any of these sums is collected

Leaving the ARP

1.28 Firms may leave the ARP for a variety of reasons including:

- *Closure* – the Principals may decide that the firm is not viable and that the Firm must close without successor. The ARP will be responsible for providing 6 years run-off cover for which an additional premium equivalent to the annual ARP premium is payable.
- *Intervention* – the SRA may intervene in the practice which has the effect of closing the Firm and triggering run-off cover.
- *Succession* – the firm may be acquired by another firm with Qualifying Insurance outside the ARP in circumstances where the other practice is a successor practice for the purposes of the Minimum Terms and Conditions of cover. In these circumstances the ARP does not provide run-off cover. Future claims arising against the ceased practice will be dealt with under the successor practice's Qualifying Insurance.
- *Obtaining market cover* – the firm may be able to secure cover with a Qualifying Insurer. If the firm comes out of the ARP part way through an indemnity period then it may be entitled to a rebate of some of the ARP contribution paid.

Historical ARP data

1.29 Relevant ARP data is set out in annexes 1 to 8 as follows:

- Annex 1 – ARP loss ratios (that is paid and reserved claims, called incurred claims, as a percentage of ARP premium received) by indemnity year.
- Annex 2 – Qualifying Insurer Participation Cost (that is total paid and reserved ARP claims and ARP running costs as percentage of total Qualifying Insurance premium income).
- Annex 3 – Time within the ARP (applied firms)

- Annex 4 – Claims made from activity undertaken while insured by the ARP (Applied firms).
- Annex 5 – ARP firm size by number of principals (applied firms).
- Annex 6 – ARP Premium Collection (applied firms).
- Annex 7 – Applied firms by total number and total number of principals.
- Annex 8 – ARP firms by ethnicity compared with all firms by ethnicity.

Possible concerns with the ARP

1.30 A number of concerns have been raised about the ARP over the years including:

- (1) **Failing firms are allowed to continue** – There is an argument that all the ARP does is to allow failing firms to continue, potentially causing problems for clients, and generating more claims, which could be avoided if firms that could not obtain Qualifying Insurance in the open market were forced to close.

Commentary – a break down of claims by date of cause of action is shown in Annex 4. The cause of action date is unrecorded for half of all ARP claims made. Where the data is known approximately one fifth of claim volume and incurred value relates to work undertaken during the period of ARP membership.

In most years few firms are insured by the ARP. The numbers are set out in Annex 5.

Annex 3 gives a breakdown of time spent in the ARP. Capita are not able to provide any data on those firms leaving the ARP having found cover in the commercial market within the first sixty days of the insurance year. The reason for this is that the ARP policies are cancelled ab initio once alternative cover is sourced and they are deemed never to have been insured within the ARP. In an average year one in six Applied ARP Firms is a renewal. More than two thirds of firms will stay for the full twelve months (includes those in run-off). Almost one third will cease with a successor firm in place or go into run-off. Relatively few firms leave after a short period of membership (6-12 months) suggesting that those who do not find alternative cover quickly either stay for the year or close and go into run-off.

- (2) **Failure to collect premium** – Insurers are concerned that ARP premium collected as a proportion of the ARP premium due is too low. In respect of some indemnity periods less than 30% of premium due has been collected.

Commentary – a break down of ARP premium collection by indemnity year is set out in Annex 6. The level of premium default within the ARP is very high. The best year saw almost one fifth of premiums

uncollected while the worst almost three quarters. Default rates appear to have an inverse relationship with the number of firms within the ARP. This could suggest that each indemnity year has a consistent core number of firms who represent a particularly poor default risk but when firm volumes increase a wider profile of firm is caught with either an improved ability or disposition to pay their premium.

ARP premium rates are up to 27.5% of gross fees declared for the smallest firms. This represents the profit margin of most small firms. Entering the ARP can put an enormous financial strain on a firm causing it to default on ARP premium. There is an argument that if the premium was set at a lower level, the level of default would reduce. However, it would make the ARP more attractive to firms, particularly those looking to close, and would have the effect of increasing the number of firms in the ARP.

- (3) Cover cannot be cancelled for non-payment** – Firms that cannot or will not pay the ARP premium due remain covered and if they close the ARP provides run-off cover.

Commentary – Strictly, it is the clients of defaulting ARP firms that remain protected. The ARP will deal with claims but with rights of reimbursement against the firm and its principals. In practice the ARP may not be able to make any significant recovery either because the principals have disappeared or else they have few assets.

- (4) High loss ratios** – On top of the premiums collected, Qualifying Insurers have paid £28m to date in the form of cash calls. The ratio of value of claims incurred to the value of premium income received for the last nine years is currently running at close to 600%. The consequence is that the ARP Manager has to make regular cash calls on the Qualifying Insurers.

Commentary – The loss ratio (incurred claims as a proportion of collected premiums as shown in Annex 1) is punitive and far greater than would be expected in the commercial market. Low premium collection rates contribute to, but do not cause, the poor loss ratio. Even with a perfect payment record, incurred claims for the years up to and including 2008/09 would still exceed premiums by more than £20m. Firm numbers do not correlate strongly with claim volumes or quantum. The year with the most members after the 2008-2009 year (2002-2003) is hard to differentiate in terms of claims volume and quantum from two of the smallest years (2005-2007).

- (5) Inability to predict exposure** – The ARP represents an open ended exposure for insurers over which they have no control. This could act as a disincentive to entry into the market.

Commentary – The average cost to insurers is £54,000 per applied firm. The current cost to insurers of participating in the ARP over the last nine years is approximately 2.15% of the qualifying insurance premiums they have received as shown by Annex 2.

What cannot be predicted with any degree of accuracy is the number of firms that will be in the ARP in the future. Annex 5 shows that the ARP is predominately made up of sole practitioners. The number of firms within the ARP is relatively volatile but does not appear to move with the insurance market cycles (the last period of hardening PI rates (2002-2004) saw static levels of firms within the ARP). This suggests that the ARP is not price sensitive but responds to a lack of supply (insurers leaving the market, non-renewals etc) in the open market. Consequently the years with the greatest number of ARP firms are not those with the highest levels of Qualifying Insurance Premium but those where insurers reduce their capacity for one and two partner firms.

Market events leading to increased ARP membership do not just impact on sole practitioners. In times of rapid ARP growth two and three principal firms make up a larger proportion of members as evidenced in Annex 7 by the divergence of the firm and Principal lines in 2001-02 and 2008-09.

- (6) Potential liability for ARP share of an insolvent insurer** – Schedule 1 to the Qualifying Insurer's Agreement provides that if a Qualifying Insurer becomes insolvent then from that point onwards the due proportions of the ARP for remaining insurers are recalculated excluding the premium income written by the insolvent insurer.

The review of the ARP

- 1.31 The Committee set up an ARP Review Working party made up of three members of the Committee to undertake the review. In addition a Consultative Forum was established made up of the three members of the Working Party, three representatives of the Qualifying Insurers and three representatives from the representative Law Society. The purpose of the forum was to give the insurers and the Law Society the opportunity to contribute views and ideas.
- 1.32 The Working Party has held separate bilateral meetings with the three representatives of the Qualifying Insurers and three representatives from the representative Law Society, a full meeting of the Consultative Forum and a meeting with representatives of black and minority ethnic (BME) firms.

Outline proposals

- 1.33 The following outline proposals for change to the ARP are suggested:

Proposal 1 – Cease issuing ARP policies

- With effect from 1 October 2010 the ARP will cease to provide ARP policies, save to firms already covered by the ARP. Firms that are insured by the ARP as at 30 September 2010 and which under the current Rules are eligible to be insured by the ARP for all or part of the indemnity year 2010-2011 may, if they wish, be insured by the ARP.

- Any existing firm that can not obtain insurance, after a short period of grace following renewal, would be required to close or face intervention by the SRA (in effect, closure).
- The last insurer would then provide run-off cover for the next six years.

1.34 Proposal 1 represents the SRA's firm recommendation to alleviate the pressure put on the current arrangements by the ARP. Proposals 2 and 3 would effect some small improvement but in the view of the SRA would not be sufficient adequately to address the problems.

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

- The ARP will accept new insureds provided that they have previously been insured by a Qualifying Insurer. It will not accept any firm that has not previously held Qualifying Insurance in the commercial market.

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

- The maximum period in the ARP should be reduced from 24 months to 12 months.

1.35 Regardless of whether Proposal 1, or Proposals 2 and 3, are adopted the Successor Practice definition is being reconsidered to see if greater flexibility can be introduced to make mergers and acquisitions more attractive. This is the subject of a separate but related consultation running along the same time frame.

2. Proposed changes

Proposal 1 – Cease issuing ARP policies

- 2.1 Indications are that only a very small number of firms have remained in the ARP for 12 months or more and then have been able to secure Qualifying Insurance in the market. So instead of assisting firms to get back into the market, the effect of the ARP seems only to postpone the demise of the firms that enter it. It is proposed that with effect from 1 October 2010 it will no longer be an option for a firm to enter the ARP. It is proposed that firms that are in the ARP on 30 September 2010, if eligible, will be entitled to remain in the ARP until they cease to be Eligible Firms.
- 2.2 The consequence of this is that any firm that has not secured Qualifying Insurance by 30 September would be required to close or would face intervention. It is proposed that in these circumstances the firm's existing policy of Qualifying Insurance would be extended by one month expiring on 31 October to enable the firm to obtain Qualifying Insurance; to effect a merger or acquisition; or else to close in an orderly fashion.
- 2.3 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.

2.4 This proposal will have resource implications for the SRA as there is the potential for a large number of firms carrying on in practice or being abandoned after the end of the one month period. It will take time for the SRA to intervene into all these practices. To reduce the scale of this problem it is proposed that various steps are taken as follows:

- Firms should be made aware of their position as soon as possible and if there is no real prospect of obtaining Qualifying Insurance they should be given guidance on the various ways of ceasing as a discrete legal practice e.g. by means of a merger/acquisition or through closure prior to the end of the one month period.
- Consideration should be given to making the definition of successor practice more flexible as referred to in paragraph 1.35 above.

2.5 Some of the likely effects of this approach are that Qualifying Insurers will not be required to insure through the ARP those firms that they have decided not to insure through the market. High risk firms will be removed more quickly than under the current arrangements. One of the issues the proposal raises is the SRA's capacity to deal in fairly short order with a large number of firms practising without renewing their Qualifying Insurance. There is a resource issue for the SRA which we are currently considering. In the long term there is likely to be a reduction in regulatory costs in other areas associated with ARP firms e.g. monitoring costs, costs of handling waiver applications and appeals.

2.6 If the ARP ceases to provide policies of Qualifying Insurance it will remove the safety net for essentially good firms that are experiencing a temporary problem. It is likely to make the renewal process even more stressful for some firms and could increase the moral hazard because firms in financial difficulty would have one month's 'notice' of probable intervention.

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

2.7 All Firms are eligible to be in the ARP other than firms that have been in the ARP for 24 months or more in the previous four indemnity periods and firms that are in Policy Default (that is are more than two months in arrears with payment of any sum due in respect of a Policy of Qualifying Insurance including an ARP Policy). The full definition of an "Eligible Firm" is set out in Rule 3.1 of the Solicitors' Indemnity Insurance Rules 2009.

2.8 It follows that under the existing rules, a new firm will be an Eligible Firm as it will not have been in the ARP previously and it will not be in Policy Default. Out of a total of 166 firms in the ARP as at September 2009, 36 firms were new firms which had not previously had Qualifying Insurance through the market. The widely held view is that new firms should not be eligible to be issued with an ARP policy on the basis that if a new firm is uninsurable at inception it should be prevented from commencing practice.

2.9 In this context a new firm includes:

- 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.
 - A practice that has been regulated by another regulator and is applying to be regulated by the SRA.
- 2.10 If Proposal 2 is to be adopted then it is important that the profession is made aware that securing professional indemnity insurance is one of the first things to be achieved before committing to premises and equipment. It should not be taken for granted that a policy of Qualifying Insurance will be available to every new firm.
- 2.11 The proposal is that this change should be introduced with effect from 1 October 2010.
- 2.12 One of the effects of introducing Proposal 1 is that Proposal 2 becomes redundant. A consequence of Proposal 2 is that a firm cannot commence practice unless it can obtain open market insurance. The change will also affect situations where a firm splits or part is hived off. 'New firm' will include parts of established firms that break away. The profession will need to be made aware that the break away parts would not be recognised by the SRA without a policy of Qualifying Insurance.
- 2.13 At present the ARP cannot refuse to insure any Eligible Firm. The proposal will mean that it will be harder for a new firm that has a poor business plan and/or is a high credit risk to obtain the Qualifying Insurance necessary to be able to register with the SRA as a firm.

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

- 2.14 When setting up the market based compulsory indemnity insurance scheme in 2000 it was decided that firms would be able to remain in the ARP for up to 24 months. It was felt that 24 months would provide sufficient time for a firm to address the issues making it uninsurable and for it to obtain cover in the market. Firms that were in Policy Default (i.e. were in arrears with payments to the ARP) were not eligible to remain in the ARP for a second year.
- 2.15 The SRA has reviewed the maximum period on two occasions, in 2003 and 2008. Each time the conclusion was that there was no compelling reason to reduce the period to 12 months. In practice very few firms have ever benefited from a second year in the ARP and the current view is that if the ARP was to continue, a 12 month period would be sufficient for a firm to recover or close. The SRA has the power to allow a firm to remain in the ARP beyond the maximum period set out in the rules. This power is exercised only in exceptional circumstances.
- 2.16 Proposal 3 falls away if Proposal 1 is put into effect. The consequence of Proposal 3 is that it will retain the ARP safety net for firms in difficulty and give

them time to either address their problems or else close in an orderly fashion. For a small number of firms 12 months might not be enough time to get back into the market. It is a relatively easy change to make that will not impact many firms but it might not be sufficient to address the problems identified in paragraph 1.30.

3. Equality and diversity impact

- 3.1 The SRA is committed to promoting equality and diversity within the solicitors' profession. We also have a legal obligation to show that our policies and rules are fair and non-discriminatory. If minority groups are in any way disadvantaged by a policy, we need to be able to demonstrate that the policy is a proportionate means to achieve a legitimate aim.
- 3.2 An analysis of the ethnicity of ARP firms compared with the ethnicity of all firms shows that in 2006/07 23% of ARP Firms were BME Firms and in 2008/09 the comparable figure had risen to 30%. In the profession as a whole, BME firms account for approximately 10% of all Firms.
- 3.3 The SRA has begun discussions with minority groups and is undertaking a full equality impact assessment.

4. Questions

Proposal 1

1. Do you agree that the ARP should cease to provide ARP policies, save to firms already covered by the ARP?

(If 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).
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?
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?
4. Do you agree that the change should be introduced with effect from 1 October 2010?

Proposal 2

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

Proposal 3

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?

Equality and diversity

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

Options

8. Which of the following options do you prefer the most?
 - Option 1 – Proposal 1
 - Option 2 – Proposal 2
 - Option 3 – Proposal 3
 - Option 4 – Proposals 2 and 3

How to respond

To find out how to respond to this consultation, please visit our website.

- Go to www.consultations.sra.org.uk.
- Select **Assigned Risks Pool review**.
- Click **How to respond**.

Submission deadline

The deadline for the submission of responses is 12 February 2010.

Annexes

Annex 1: ARP Claims Summary @ 30 September 2009

Year	No. of Claims	Premium Received	Paid & Reserved Claims (Applied Firms)	Paid & Reserved Claims (Non-Applied Firms)	Paid & Reserved Claims Total	Loss Ratio
2000-2001	239	£942,808	£1,438,497	£8,068,489	£9,506,986	1008%
2001-2002	156	£1,357,224	£2,714,568	£479,582	£3,194,150	235%
2002-2003	262	£1,249,412	£3,013,202	£739,482	£3,752,684	300%
2003-2004	117	£687,007	£1,299,814	£463,794	£1,763,608	257%
2004-2005	67	£452,428	£146,409	£110,922	£257,331	57%
2005-2006	152	£406,047	£3,106,556	£59,638	£3,166,194	780%
2006-2007	108	£276,651	£5,829,916	£51,343	£5,881,259	2126%
Sub Total	1,101	£5,371,577	£17,548,962	£9,973,250	£27,522,212	512%
2007-2008	208	£213,969	£2,355,094	£236,002	£2,591,096	1211%
2008-2009	399	£1,677,044	£13,387,093	£24,596	£13,411,689	800%
Total	1,708	£7,262,590	£33,291,148	£10,233,849	£43,524,997	599%

Notes

Data includes applied firms (valid application form has been submitted) and non-applied firms (deemed members but application form outstanding).
 Paid and reserved figures include unpaid excesses which may be recoverable.
 Premium figures exclude Insurance Premium Tax.

Annex 2: Qualifying Insurer participation cost

Year	Qualifying Premium Income	Participation Cost
2000-2001	£154,093,886	6.25%
2001-2002	£166,304,164	1.60%
2002-2003	£225,498,694	1.46%
2003-2004	£251,405,392	0.66%
2004-2005	£242,696,429	0.10%
2005-2006	£244,797,983	1.28%
2006-2007	£215,630,802	2.73%
2007-2008	£206,796,001	1.32%
2008-2009	£226,008,008	5.48%
Total	£1,933,231,359	2.15%

Notes

Participation cost is the cost to Qualifying Insurers of paid and reserved claims plus ARP running costs expressed as a percentage of the premium income they receive.

Annex 3: Months within ARP (applied firms) per year of indemnity

Year	Less than 6 Months	6 months up to but not including 12 Months	12 Months
2000-2001	11.6%	0%	88.4%
2001-2002	53.7%	4.4%	41.9%
2002-2003	21.7%	10.0%	68.3%
2003-2004	30.5%	8.5%	61.0%
2004-2005	26.3%	15.8%	57.9%
2005-2006	21.2%	9.1%	69.7%
2006-2007	37.5%	3.1%	59.4%
2007-2008	39.3%	17.9%	42.9%
2008/2009	15.1%	8.4%	76.5%

Annex 4: Claims made for activity undertaken while insured by the ARP (applied firms)

Year	Claim for activity undertaken while ARP member		Claim for activity undertaken pre ARP membership		Claim for activity undertaken at a date unknown	
	(Volume)	(Quantum Incurred)	(Volume)	(Quantum Incurred)	(Volume)	(Quantum incurred)
2000-2001	18	15.5%	50	13.5%	5	0.1%
2001-2002	28	29.1%	24	9.0%	20	12.3%
2002-2003	16	8.4%	31	5.7%	136	18.9%
2003-2004	5	0.7%	30	10.7%	23	1.9%
2004-2005	2	0.2%	6	0.9%	24	0.5%
2005-2006	3	0.0%	40	17.9%	87	10.3%
2006-2007	7	0.0%	11	0.4%	45	37.2%
2007-2008	3	0.1%	45	15.9%	10	2.0%
2008-2009	9	46.1%	75	26.0%	37	16.9%
% of Total	12%	8%	39%	36%	49%	56%

Annex 5: ARP Membership (applied firms) by number of partners

Year	Firms	Partners	Sole practitioner %	2 Partner %	3 Partner or more %	Claims/Firm
2000-2001	69	86	78%	20%	1%	£20,848
2001-2002	136	197	64%	29%	7%	£19,960
2002-2003	60	76	73%	27%	0%	£50,220
2003-2004	59	77	78%	17%	5%	£22,031
2004-2005	38	52	68%	29%	3%	£3,853
2005-2006	33	41	82%	12%	6%	£94,138
2006-2007	32	44	72%	22%	6%	£182,185
2007-2008	28	35	79%	18%	4%	£84,110
2008/2009	166	246	59%	32%	9%	£80,645
Total	621	854				

Annex 6: ARP premium collection (applied firms)

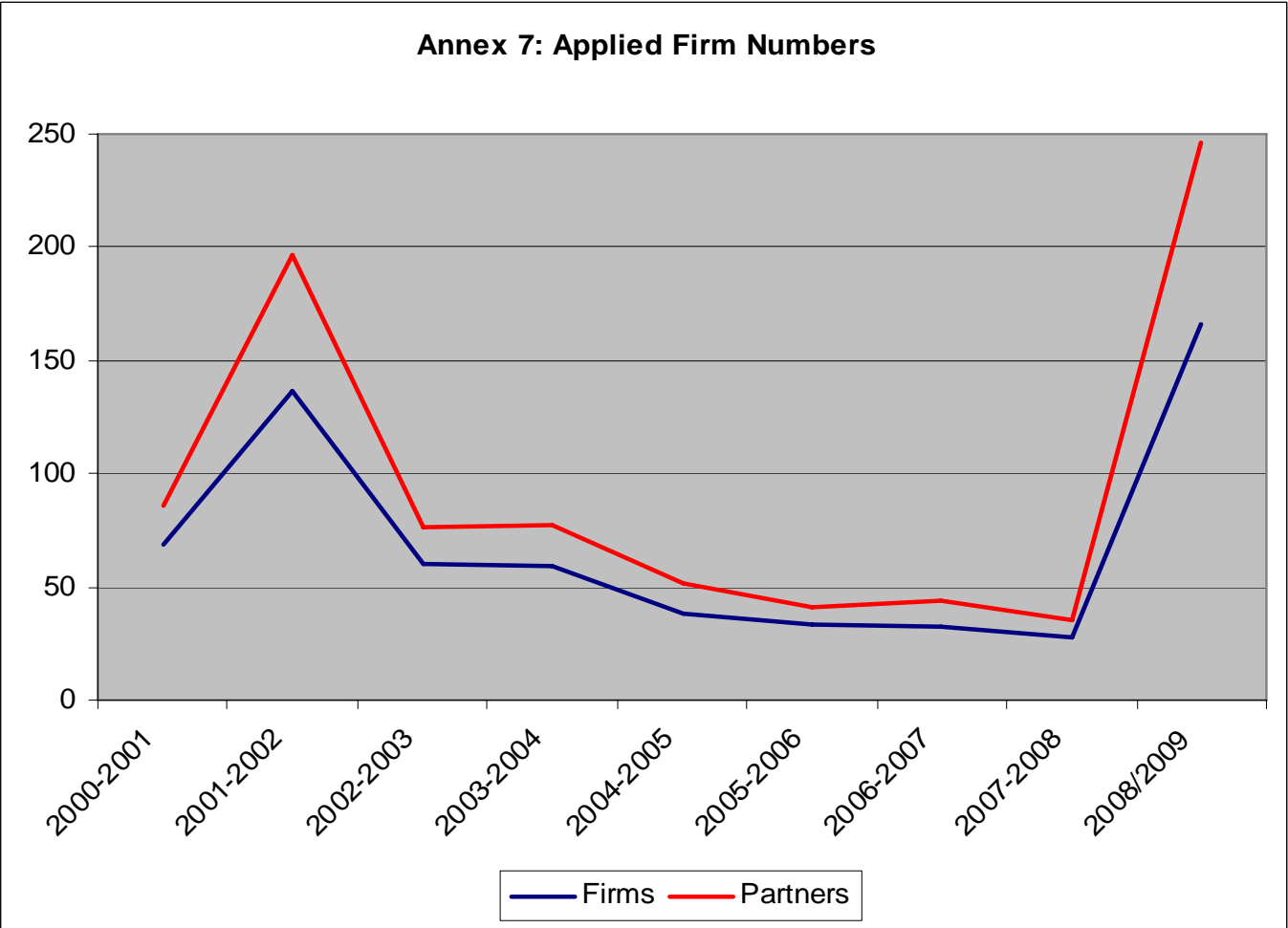
Year	Premium Due	Premium Paid	Premium Unpaid	Default Rate
2000-2001	£1,490,008	£942,808	£547,200	36.72%
2001-2002	£1,914,432	£1,357,224	£557,208	29.11%
2002-2003	£2,200,096	£1,249,412	£950,684	43.21%
2003-2004	£1,736,370	£687,007	£1,049,363	60.43%
2004-2005	£729,414	£452,428	£276,986	37.97%
2005-2006	£1,476,054	£406,047	£1,070,007	72.49%
2006-2007	£874,289	£276,651	£597,638	68.36%
2007-2008	£270,007	£213,969	£56,038	20.75%
2008/2009	£6,492,083	£1,677,044	£4,815,039	74.17%
	£17,182,753	£7,262,590	£9,920,163	49.25%

Notes

Total default rate based on an average (mean).

Premium figures exclude Insurance Premium Tax.

Annex 7: Applied Firm Numbers



Annex 8: Ethnicity of firms previously in the ARP – 2006/07 to 2008/09

In ARP for more than 30 days

Indemnity Year	BME	Unknown	White	No Majority Group	Grand Total
2006-07	6 / 23%	3 / 12%	12 / 46%	5 / 19%	26 / 100%
2007-08	6 / 23%	5 / 19%	10 / 38%	5 / 19%	26 / 100%
2008-09	49 / 30%	30 / 18%	61 / 37%	24 / 15%	164 / 100%
Grand Total	61 / 28%	38 / 18%	83 / 38%	34 / 16%	216 / 100%

In ARP for more than 60 days

Indemnity Year	BME	Unknown	White	No Majority Group	Grand Total
2006-07	5 / 23%	3 / 14%	10 / 45%	4 / 18%	22 / 100%
2007-08	4 / 20%	3 / 15%	9 / 45%	4 / 20%	20 / 100%
2008-09	45 / 28%	30 / 19%	60 / 38%	24 / 15%	159 / 100%
Grand Total	54 / 27%	36 / 18%	79 / 39%	32 / 16%	201 / 100%

Overall firm population at start of ARP years

Indemnity Year	BME	Unknown	White	No Majority Group	Grand Total
2006-07	926 / 9%	599 / 6%	8037 / 77%	880 / 8%	10442 / 100%
2007-08	1012 / 10%	624 / 6%	8022 / 76%	883 / 8%	10541 / 100%
2008-09	1100 / 10%	640 / 6%	8083 / 75%	889 / 8%	10712 / 100%

Based on Capita data

Ethnicity based on, in priority:

- Ethnicity at start of ARP year
- Ethnicity at mid-point in ARP year
- Ethnicity at start of next ARP year

Where no data available at any of these points, the firm has been removed from the analysis