

Summary report on a minimum financial strength rating requirement for participating insurers

1. Introduction

- 1.1. On 28 January 2014 we issued a consultation paper seeking views on the proposed introduction of a minimum financial strength rating requirement upon Participating Insurers. The consultation closed on 24 March 2014 and this is the initial report summarising the key points emerging from the responses. A summary by number of the answers to the questions posed is at **Appendix 1**. A breakdown of the composition of respondents and a list of those respondents who consent to their details being publicised is at **Appendix 2**.
- 1.2. There were 31 responses to this consultation. Improved stability is the driver behind those who see the proposal as positive, believing it will make the market more secure and enhance public protection. The majority of firms that disagree with the proposal are sole principals. They are concerned about restricting the market and the disproportionate negative effect on them and small firms, where use of unrated insurers is concentrated, believing that removal of unrated insurers could lead to closure and reduced access to legal services for their clients. These concerns echo the Law Society's which is not in support of the proposal.

2. The Responses

Question 1: Do you agree with our recommendation to introduce a long term insurer financial strength rating requirement into the Participating Insurer criteria with a minimum rating set in the "B" ("secure" group)?

- 2.1. 18 respondents agree and 13 disagree, across a wide range of different respondents. The Law Society does not support the proposal.

Question 1.1: If you do not agree, please explain why not

- 2.2. There are a variety of concerns. These include doubts about the SRA's role in regulating the financial stability of insurers, the risk of too much reliance on rating agencies, the disproportionate and negative impact for small firms leading to lack of competition, and the potential for a reduction in access to legal services. It was felt it would also lead to increased premiums and higher costs for clients. Others felt such a change is at too short notice and does not allow sufficient time for the current unrated insurers to achieve a rating. There was also the view that a rating requirement is a short term solution and that there should be a detailed review of the breadth of cover.
- 2.3. The Law Society believes a rating requirement does not address the issue of insurer insolvency and will not eliminate the risk of further unplanned insurer exit. It could have a destabilising effect and negative consequences for a significant number of firms, in particular BME firms, sole principals approaching retirement and female-led firms.

Question 1.2: Do you have an alternative proposal?

2.4. Proposals from respondents in agreement include a “passporting” measure for firms currently insured with unrated insurers.. Suggestions from respondents in disagreement range from some form of independent vetting of insurers before they become “authorised insurers” in the first place through to ending the requirement for run-off cover or making compulsory insurance optional. The Law Society suggests a second consultation based on advice from a recovery accountancy practice and a competition impact assessment.

3. Question 2: Do you agree that the acceptable rating agencies should be limited to Standard & Poor’s (S&P), A.M. Best, Fitch and Moody’s coupled with a facility for other agencies to apply to be added to the list of recognised agencies?

3.1. 20 respondents agree and 11 disagree, again across a wide range of different types of respondents. Comments include the need for transparency around ratings agencies themselves to demonstrate breadth of knowledge, experience and resource and awaiting the introduction of Solvency II.

4. Question 3: Do you agree that the minimum rating requirement should apply to the insurer itself?

4.1. 19 respondents agree and 12 disagree. The various views include applying the rating to the insurer itself as it is the insurer which will be responsible for dealing with any claims and ignoring any reinsurance arrangements. Others believe the rating should apply to the group where the insurer is part of a larger group.

5. Question 4: Do you have any further comments you wish to make about this proposal?

5.1. Again there is a divergence of views. What stands out is the difficulties small firms will face if the competition brought to the market by unrated insurers is removed, which risks such firms being unable to find alternative or affordable insurance and potentially their closure. Removal of unrated insurers could unbalance the market. On the other hand, some feel that the participation of unrated insurers represents a threat to public protection and a rating will encourage financially strong, experienced players to the market. Others make the point that even an “AAA” rating cannot be relied upon as an indicator of financial strength, which the Law Society reiterates. There is also a theme that it is the breadth of the Minimum Terms and Conditions that are the problem.