Cardiff and District Law Society's response to SRA Consultation – 'Protecting the users of legal services: balancing cost and access to legal services – March 2018'

The Incorporated Law Society for Cardiff and District trades under the name Cardiff and District Law Society (CDLS). CDLS is the largest local law society in Wales. It has a membership of over 1,000, including solicitors, barristers, legal executives and academic lawyers.

CDLS appoints a number of specialist committees, including a Regulatory Issues Sub-committee. Through these committees CDLS responds to a number of public consultations on matters which affect the professional lives of solicitors in the Cardiff and District area. CDLS welcomes the opportunity to respond to the SRA's Consultation on Professional Indemnity Insurance and the Compensation Fund.

Introductory/general comments

In general, we do not agree with the SRA's proposals – we do not consider that the changes to the Professional Indemnity Insurance regime or to the Compensation Fund are needed or that they will achieve the outcomes envisaged by the SRA. At the same time the proposals will seriously undermine protections for both clients/the public and for solicitors.

We have also had the benefit of seeing the response of the Law Society of England and Wales, and we endorse the views expressed in the Law Society's response.

Question 1

To what extent do you think the proposed changes to our PII requirements provide an appropriate minimum level of cover for a regulated law firm?

Strongly Disagree

Please explain your answer

We **strongly disagree** with the proposal to reduce the minimum level of cover to £500,000/£1million for conveyancing firms.

We understand that the SRA has provided statistical data in its proposals that claims that if the minimum level of protection was reduced to £580,000 then 98% of claims would be met. We have some observations on this claim which we believe casts serious doubt on the sense of the proposals to reduce the minimum level of cover.

1 Firstly, we have concerns over the validity of the data which the SRA says covers the period from 2014. The SRA's data does not include data from insurers who have left the market during that period. We understand that these insurers represented 26% of the total market. To the extent these insurers collapsed or left the market due to the extent of the PII claims that they had to cover under policies they had written (such as Quinn or Balva) these claims might be expected to influence the SRA's data, particularly as these insurers would be likely to provide cover to disproportionately greater number of the higher risk firms.

2 There is no data since 2014 and does not reflect changes that have taken place in the intervening period. Most significantly we feel that this period excludes the more recent instances of cyber-fraud which has become a significant risk for law firms. We understand that there are many instances in which claims for this kind of fraud exceed £500,000.

3 The £580,000 figure relied upon by the SRA reflects the settled cost of claims and does not include the total amount claimed nor defence costs. If firms took out the minimum level of insurance they would not be covered for their defence costs to the extent these took the overall level of liability to above £500,000.

Leaving aside our concerns over the validity of the data itself, on the SRA's own figures, a significant number of claims would fall outside the £500,000 minimum level proposed by the SRA. On that basis, unless firms elected to purchase top-up cover, a number of claims would be uninsured. It is also unclear what number of claims fall within the £500,000 to £580,000 range as these would also be potentially uninsured.

We have further concerns over the £1,000,000 minimum cover that is proposed for conveyancing firms. The figure seems arbitrary and does not take into account the wide regional variations in house prices. For conveyancing transactions in London, £1,000,000 of cover is likely to be hopelessly inadequate when considering the adequacy of PII cover.

Whilst we agree with the SRA's objective of reducing the burden of regulation, we don't believe that these proposals will achieve that aim. To the extent there are an increased number of uninsured claims (which seems likely just based on the SRA's own data as outlined above) there would be increased disruption for firms and their partners who face uninsured losses. That will lead to an increased number of failures of firms, an increase in the burden on the Compensation Fund plus an increase in the overall cost of regulation, with the SRA presumably having to undertake more enforcement action as a result. Firms engaged on matters having a value in excess of £500,000 will face an increased burden of having to assess the risk of dealing with another firm on the other side and whether they have adequate PII cover e.g. in being able to rely on undertakings, whilst the current arrangements give firms cover in knowing that there is a reasonable minimum level of cover without having to make that assessment. There will be a cost of having to make such

assessments, which will either have to be borne by the firms themselves or passed onto their clients. None of this would appear to be in the interests of clients.

We also believe that the market for top-up cover will become more complicated. In practice, responsible firms will purchase top-up cover and we are concerned that it will take longer to apply for, with potentially three different aspects having to be covered if a firm wishes to purchase general top-up cover as well as conveyancing cover and cover for large financial institutions and business clients. We also believe, having spoken to insurance brokers, that top-up cover will become more expensive to purchase.

We note the SRA's assumption that there is a potential cost-saving of 9-17%. However, we are dismayed to note that the SRA has not asked insurers to provide any indicative quotes for the minimum cover nor for top-up cover to evidence its claim and we would ask that the SRA do this before the proposals can be considered further.

Question 2

To what extent do you agree that our minimum PII requirements do not need to include cover for financial institutions and other large business clients?

Strongly Disagree

Please explain your answer

Firstly, we believe that the definition of what constitutes a large financial institution is too simplistic, as it is based only on turnover. We believe that a threshold of £2,000,000 turnover is wholly inadequate in assessing whether a business is a sophisticated purchase of legal services. Many relatively small businesses have a turnover in excess of this amount but they do not necessarily purchase legal services regularly.

Secondly, in practice, those financial institutions who truly are sophisticated are likely to require the firms that they deal with to have additional top-up cover. Those who aren't sophisticated enough to understand the implications of the solicitors' PII rules are unlikely to require firms to purchase top-up cover whereas these are exactly the kind of businesses who need the additional protection that the current rules afford.

Thirdly, we believe that the proposal will add to the regulatory burden for firms, as it will not necessarily be easy for a firm to determine what a client's turnover is at the time the work was done, and those records will need to be maintained for as long as it is possible

that a claim may be made. That burden will lead to increased costs, which will either have to be borne by the firm or passed onto the client.

Fourthly, we think this will add to the complexity and cost of obtaining top-up cover.

Finally, most firms who undertake conveyancing work will act for lenders alongside buyers. Many smaller firms undertake conveyancing work. Lenders and mortgage panels are likely to require top-up cover be purchased at a minimum level as a condition of instructing a firm. If top-up cover becomes harder and more expensive to maintain then it is these smaller firms who are likely to be priced out of the market leading to a reduction in competition for consumers.

Please provide any additional comments on the alternative option that this could be at the election of the law firm

We do not see how this will work in practice. Lenders and truly sophisticated purchasers of legal services will require top-up cover to be purchased taking this decision out of the hands of the firm. Those smaller businesses who don't require their law firms to purchase top-up cover are likely to be on the more unsophisticated end of the scale and are really the ones that require the protections that the Minimum Terms currently provide.

Question 3

Do you think our definition for excluding large financial institutions corporations and business client is appropriate?

No

If no, please provide an alternative way of drafting the exclusion definition.

As stated above, using turnover on its own as a means of determining who is a large financial institution is too simplistic and bears little relation to how sophisticated a purchaser of legal services they may be. Other factors, such as number of employees, how regularly they purchase legal services, what type of legal services they purchase and their asset base, are also relevant. Clients may satisfy the turnover threshold with one property transaction whereas another business with similar turnover may have several employees and require employment law advice, debt or equity funding and so may require corporate and banking advice and have a number of commercial contracts which require advice. Their needs and degree of sophistication are very different.

If there is to be only one test for "large", and it is to be based on turnover, then we submit that £2,000, 000 is far too low.

Over 99% of businesses in the UK qualify as SMEs. Whilst there are several different definitions of a medium business, it will generally have up to 250 employees and a turnover of at least £10,000,000. This is significantly in excess of the SRA's proposal to define a large business solely by reference to turnover in excess of £2,000,000.

Question 4

To what extent do you agree that we should introduce a separate component in our PII arrangements meaning only firms that need to have cover for conveyancing services are required to buy this cover?

Strongly Disagree

Please explain your answer.

We do not believe there is any need to implement any changes for the following reasons.

Unnecessary Complexity

The current MTC's provide simple and robust protection to clients, lenders and law firms. By making the system of assessing what level of cover is required far more complex and entirely down to each individual law firm it is highly likely to have the opposite effect to which the SRA's proposals suggest:

- The complexity of assessing what level of cover required will mean that smaller law firms who in the past have dealt with conveyancing on an ad hoc basis will no longer do so. It will also put off potential new entrants to the market. This will reduce choice of the service provider for consumers and inevitably increase cost where there is less competition.

- There is a much greater chance that a law firm will not have sufficient insurance cover. Owners of law firms who deal in conveyancing do not have the expertise or knowledge to assess what level of risk they should be covering against. It is likely that a claim relating to a property under £1M will result in compensation of over £1M being paid. The law firm owner would have assumed they were complying with the new proposed requirements but still find themselves under-insured. This will

have a disastrous effect on the law firm, the client and the perception of the profession in general.

There will be a much greater risk to consumers and clients of engaging a law firm who are unwittingly under insured for the work they are carrying out.

- The added complexity of assessing and arranging layers or tiers of additional PII cover will add an extra administrative burden on law firms as well as increase the premium and administrative costs of carrying out all levels of conveyancing transactions.

  These additional costs and administrative expenses will no doubt result in law firms increasing conveyancing fees for consumers. It is also likely that the increased cost and administrative burden will result in less law firms engaging in conveyancing work, reducing competition which will increase cost to the consumer and stifle innovation.

  The increased costs for dealing with conveyancing will put off new entrants into the conveyancing market which will hinder future choice for consumers as law firms currently engaged in conveyancing retire, merge or close down. There will be no incentive to innovate as the firms left in the market will have less competition and be able to charge higher fees to the consumer.

<u>Mortgage Lender issues</u>

It is already common place for mortgage lenders to exclude sole practitioners and sub-4 partner law firms from their conveyancing panels.

The uncertainty as to whether a law firm is sufficiently covered would likely result in the following:

- All but a few large law firms, who can be efficiently assessed and monitored by the lender, being removed from lender's conveyancing panels.

- Lenders requiring law firms to have much higher levels of PII cover than the newly proposed amounts and higher even than the current PII level to ensure that any potential risk to the lender is covered by insurance.

- Increased costs to law firms to cover the fees of panel management companies employed by lenders to assess a law firms' suitability for joining or remaining on each lender's conveyancing panel.

- Where lenders reduce their conveyancing panel, far greater instances of those lenders being separately represented by firms remaining on panel, doubling cost to clients.

- As mortgage lenders fall within a category of entities not covered by the proposed minimum terms they would require additional insurance to be taken out by a law firm as a pre-requisite of them being admitted to the lender's conveyancing panel.

The consequences of these actions for smaller, conveyancing-centric law firms will be catastrophic. When a law firm is no longer on a lender's panel it is inevitable that they will lose clients to firms who are on panel. With fees already squeezed in conveyancing this will result in the disorderly closure of very many law firms on financial grounds.

There will be less choice for the consumer in who carries out their conveyancing and due to the lack of competition, cost for the consumer will increase while innovation flounders.

By far the most widely used legal service by consumers is conveyancing. If the SRA wish to increase suppliers of conveyancing whilst protecting consumers and reducing costs then there are far more effective ways of doing so rather than changing the whole PII market.

An example would be requiring all mortgage lenders to include each and every law firm who is regulated by the SRA and has the minimum level of PII under the current system on their conveyancing panels. This would increase the number of conveyancing providers, attract new providers to the market and reduce cost to the consumer through increased suppliers of the service whilst retaining the 'gold-plated' indemnity insurance cover currently offered by the profession.

This, together with stricter controls on non-declared referral fees paid to estate agents or mortgage brokers, would do far more to achieve the SRA's proposed goals rather than these current ill thought-through PII proposals.

<u>Conclusion</u>

It is clear that if you follow through the rationale of imposing greater PII administrative burdens and expenses on conveyancing practices the result will be an increase in costs of

insurance premiums, fees to PII brokers and internal administrative time, all of which will result in an increase cost of conveyancing to consumers.

The most likely outcome is that due to the increased cost to a law firm and the likely stance of mortgage lenders should these changes come about there will be much less competition in conveyancing service suppliers. This would have a detrimental effect on consumers at the same time as increasing the risk that the law firm they engage is under-insured in the event of a property claim.

Question 5

Do you think our proposed definition of conveyancing services is appropriate?

No

If not, please explain what you think should be an alternative definition.

We believe that the inclusion of the words '…and other service ancillary to…' is too vague and far reaching. An alternative suggestion would be:

"Dealing with transfers, conveyances, leases, contracts, deeds, grants, mortgages, charges, licences and other documents in connection with the disposition, acquisition or creation of estates or interests in or over land and the sale and purchase of companies whose primary asset is an estate or interest in land."

Question 6

Do you think there are changes we should be making to our successor practice rules?

~~**Y/N**~~

If yes, please explain what these are and provide any evidence to support you view.

On the basis that we do not agree there should be amendments to the MTCs or PIA, it would be our view that the successor practice rules do not need to be amended.

However, if the proposed amendments to the MTCs or PIA are approved, there must necessarily be some changes to the successor practice rules. In the event that the proposed amendments to MTCs or PIA are approved, it is highly unlikely that any firm would be able

to risk becoming a successor practice to another firm as they will be unable to know with any certainty whether their own level of PII cover would be sufficient for the work undertaken by the firm to be succeeded. It would also mean that a retiring party would likely have to obtain their own insurance because they would have also have no way of knowing whether the successor practice was providing adequate protection under their own policy. Given that one of the professed aims of the proposals is to make retirement from practice easier, it would be our view that it would in fact cause the opposite.

Question 7

Do you agree with the approach we are taking to bring the MTCs and the PIA up to date?

Strongly disagree

Please explain your answer.

Do you have any detailed comments on the changes we have made to the provisions in the MTCs?

We do not believe there is any need to implement any changes. The evidence produced by the SRA is out of date and therefore should not be relied upon to make a change of this magnitude. We understand that the evidence is only accurate up to 2014 and that there have been significant increases in cyber fraud since that date which all agree is one of the largest risks facing our profession at the moment. Unless more up to date evidence is obtained, we firmly believe the status quo is preferable to any change.

In respect of the proposals to amend the MTCs, the evidence we have seen from information prepared by insurance companies and brokers would suggest that in all likelihood there will be a nominal reduction in premiums for some insured but in the majority of cases there will be an increase in premiums for most firms who would wish (and need) to maintain their current level of cover. Even on the evidence provided by the SRA in respect of reduced premiums, the levels are relatively small and would not encourage new entrants to the market and would not see costs savings to individual clients, to that end, it would not increase access to justice as intended. Indeed, we believe it would see the end of general practitioners who cover a variety of areas of legal work and it would likely lead to further “advice deserts” in rural or low populated areas.

As the data the SRA is working on was obtained from 90% of the insurers in the market and therefore did not include data from insurers who left the market, i.e. Quinn, Lemma, Balva etc., who have left the market because of insolvency caused by claims pay-outs, the evidence provided by the SRA to justify a change is significantly incomplete. If a change is contemplated, additional data is required.

Question 8

To what extent do you agree that the changes to our PII requirements provide law firms with more flexible options to potentially lower insurance costs?

Strongly disagree

Please explain your answer

At first blush the SRA proposals appear to be reasonably sensible. However, a little probing makes them look rather less attractive.

1. The jewel in the Law Society's PII crown is the MTC. Once it is gone or fractured it will be difficult (if not impossible) to re-create it. As we understand it, the current MTC provides protection for members of law firms and the public far greater than any other UK profession. It is important for the regulator (SRA) to appreciate that well run and competent law firms will ensure appropriate levels of indemnity cover for their work as protection for both the owners of the firm but also their clients. It is the poorly managed or incompetent firms that need to be protected, as well as their clients, and this obvious point seems to be overlooked in the SRA paper, which largely seeks to reduce the cost of PII by reducing the protection for both lawyers and clients. Reducing the level of cover to £500,000 (£1m for conveyancing firms) will expose clients of 'low cost' firms to uninsured loss claims. The SRA figure of £500,000 is based on settlements achieved (i.e. payments) and not the amounts actually claimed at the outset. It is not hard to envisage a scenario where a claim is for £1m and the insurer (wishing to limit its costs outlay + time exposure) agrees to pay £500,000 early on in order to avoid involvement in litigation. It is the 'under insurance' potential which is of great concern to us.
2. We understand that the figure of £500,000 has been arrived at on the basis of numbers of claims settled at £500,000 or less (96%), whereas that amount by reference to amounts actually paid out by PI insurers the figure represents 56% of the total value paid, a rather different and disturbing statistic. Obviously this is an aspect which the SRA must check before proceeding with the minimum £500,000 indemnity figure.
3. We question the evidence that the SRA has that the proposals will encourage the insurance market significantly to lower premiums. Our enquiries suggest that whilst there may be some minor saving initially the insurers will make up any perceived 'shortfall' by increasing premiums for top up insurance (which is likely to be required by most (if not all) well run competent law firms). During the past 18 months (i.e. after the SRA's analysis) the cost of excess layer cover has increased, largely because of several large losses which breached the current mandatory levels of cover. As a consequence, some top up insurers have left the solicitors' market, including Brit Insurance and Channel Syndicate, while others have raised their premiums. Only a

handful of PI insurers now offer cover for £3m over £2m or £2m over £3m, i.e. up to £5m maximum. It is therefore fanciful to assume that lowering the primary level of insurance will result in overall premium reductions. The reality is that most (i.e. prudent) firms will seek cover considerably higher than the suggested £500,000 minimum cover and that by implementing its current proposals the SRA will cause increased costs to law firms and not reduced cost as its Consultation Paper suggests. There is also the danger of 'dodgy' PI insurers entering the 'low cost' market with obvious unwanted outcomes – see Quinn and Enterprise as examples.

4. In our view a better proposal is for the SRA to provide specific waivers on request from firms that want to conduct low risk work only, such as crime and housing claims. In this way a full and proper assessment can be made (as to waiver) and PI insurance cover + premium obtained as appropriate for that firm.
5. We should add that PI insurance is 'claims made' and so law firms with 'legacy' work will need run-off cover for any 'old discipline' work. We suggest that the SRA is looking the wrong way through the telescope by trying to develop a one-size-fits-all solution, when in fact a bespoke solution (for waiver applicants) is a better option.
6. As for under insurance/lack of cover, it is not difficult to imagine scenarios where law firms are inadvertently underinsured. The writer is aware of a property investment fund which had c.£5m stolen by a law firm partner where the firm's indemnity level was only £2m (i.e. under insured). Alternatively, a small law firm (sole proprietor ?) might take on a low value RTA injury claim which (through inexperience) is settled prematurely. Following settlement the client's medical condition deteriorates significantly, which would have been detected if the right discipline of medical adviser had been instructed: such a claim could easily exceed the £500,000 limit.
7. Finally, we have seen data from JLT, specialist PI brokers which queries the extent to which savings may be achievable. Since January 2018 they have placed PI cover for 38 start-up law firms where the average annual premium has been £3,000. It has been suggested in the SRA paper that (1) PI premiums are stopping new entrants coming into the market and (2) that the proposals will result in premium reductions of c.10%. We do not think it credible that new entrants to the legal market would be dissuaded by a £300 differential. If they are, then we question their financial model and suitability to practice as law firms.

Question 9

Do you agree the proposed level for the cap on cover in run-off provides adequate protection for the users of legal services whilst balancing the need for premiums to be more affordable?

Strongly disagree

Please explain your answer and what evidence you have to support your view, or if you have a view on an alternative level for the cap.

There is little evidence to show that premiums would be more affordable and it is our belief that in due course, the proposed changes are likely to lead to higher premiums for many who wish to remain insured at the current minimum level. Whilst it is appreciated that there will be some who are able to benefit from the lower cap, it is likely that those practitioners would have already had the benefit of significantly lower premiums in any event due to the low risk work undertaken. It is likely that those who have at some point been involved in the provision of higher risk services would see no reduction in a run-off premium.

Question 10

To what extent do you agree that the changes to our PII requirements could encourage new firms to enter the legal services market increasing choice for users of legal services?

Somewhat disagree

Please explain your answer

If PII premiums are potentially lower it might encourage new firms to set up in practice. What is currently unclear is an understanding of the number of solicitors who would be willing to set up a new practice because of the potential of lower premiums. We understand the cost of PII premiums is a major factor taken into account by solicitors considering setting up in private practice, but it is one of a number of factors.

If the SRA's assumption is correct and new firms are encouraged to enter the legal services market, if any of the new set-ups are in locations based in more rural areas, it would provide much needed access to justice. This is particularly an issue in Wales.

As previously stated, a more effective way of achieving this would be for new firms to apply for a waiver under the SRA's existing powers rather than implementing the proposals in relation to the MTC.

As with a number of the suggested proposals, solicitors will need to be under a clear regulatory duty to ensure their clients are made fully aware of any limits to their indemnity protection.

Question 11

Are there any positive or negative EDI impacts from the proposed changes to our PII requirements that you think we have not identified?

Yes

If yes, please explain what you think these impacts are.

Based on the information in the Consultation Paper, the EDI impacts appear to be identified. However, as a number of assumptions have been made in the consultation, it is unclear at this stage if there are any further potential EDI impacts.

We agree the proposals have the potential to open up the market for solicitors to set up on their own or in partnership, if there is a positive impact on PII premiums. This may in turn encourage for example, a higher number of solicitors from a BAME background, to set up in practice.

However, what the paper does not appear to have considered is any negative diversity implications the proposals may have, on for example, the BAME community.

Question 12

Are there any options for changes to our PII requirements that we are not proposing or have not identified that we should consider further?
Please explain why and provide any evidence that supports your view

The current proposals concern us, as it would appear that they do not serve the purpose of protecting the public or encouraging new entrants into the market. The public will have less protection and there is a danger that it will undermine public confidence in the profession. We also understand, from leading PII brokers, that there will only be marginal savings on premiums for those seeking the minimum insurance. Further, it would also penalise firms who choose to retain their current level of cover above the minimum figure, as their premiums are likely to rise.

With there being no persuasive case for change, we favour the option of no change at all to our PII requirements.

We believe that the way to achieve lower premiums is to have fewer claims. To do so, we must improve the claims record of all solicitors. SRA resources should be directed towards assisting law firms with risk management, as ultimately prevention has to be the best solution.

Question 13:

To what extent do you agree that the proposed changes to the Compensation Fund would clarify its purpose as a targeted hardship fund protecting the vulnerable that need and deserve it those in most?

Strongly disagree

Please explain your answer

The proposed changes do not clarify the existing purpose - they seek to reclassify the Compensation Fund as a hardship fund. We do not believe the SRA has the power to change the purpose of the Fund.

Its purpose is to be a fund of last resort, as a safety net for clients who are victims of dishonesty of solicitors or hardship due to a solicitor's failure to account for monies, or to provide compensation in respect of the civil liability of a defaulting practitioner who does not have a policy of qualifying insurance policy in place.

We are also concerned that the £250,000 household asset bar could have perverse and unintended consequences, which will lead to deserving victims not being eligible for payments from the Fund.

Question 14

Are there any options for changes to how we manage the Compensation Fund that we have not identified that we should consider further?

Please explain why and provide any evidence that supports your view.

As payments from the Fund are discretionary, we suggest that the SRA publish guidelines showing that the Fund is not a source of redress for investors who have suffered a loss, purely due to the involvement at some point of a solicitor. There has to be clear causation between the work undertaken by the solicitor, or advice given, and the loss suffered by the investor.

As part of exercising its discretion, the SRA should refuse claims by investor clients who have not sought pre-investment advice from an FCA authorised IFA. For those investor clients, the Compensation Fund could avoid paying compensation for dubious investments, as any

financial liability for losses will be that of the IFA who recommended/approved the investment.

We agree with the view of the Law Society of England and Wales that the SRA should seek to reduce the costs of interventions on the Compensation Fund, or even to remove the cost of interventions from the Compensation Fund altogether, with the costs of interventions being paid for out of the SRA's general funds. It cannot be right that the percentage of the Compensation Fund being used on interventions should have risen from 2.2% to 27.7%, as this is not the purpose of the Compensation Fund. If the SRA considers that it needs more general funding to meet the costs of interventions then this should be properly costed (and justified) so that an appropriate financial settlement can be reached on the SRA's funding.

Question 15

To what extent do you agree that we should exclude applications from people living in wealthy households?

Strongly disagree

Please explain your answer

We do not agree with the proposal that applications from persons living in wealthy households should be excluded, because we do not agree with the proposal that the Compensation Fund should become a 'hardship fund'.

Question 16

Do you think our proposed measure of wealth and threshold for excluding these application is appropriate?

No

If no, do you have any suggestions for an alternative measure of wealth and or at what level the threshold should be set?

We do not agree that the Compensation Fund should be re-purposed as a 'hardship fund', but if it were, we do not believe the proposed measure of wealth is appropriate.

If the Compensation Fund is to be a 'hardship' fund, then we do not see the rationale for excluding certain types of wealth and assets. Whilst we can see a case for excluding a claimant's own home in most cases, what is the justification for excluding homes worth several million pounds? What is the justification for excluding second homes and

investment properties, or very substantial business assets? A focus on net financial wealth could lead to unfairness between claimants, depending on the nature of their wealth.

Although there is the need to value certain forms of assets (real and personal property, business assets), this should not be a reason for excluding them entirely from a consideration of a person's means. Otherwise, there is too much emphasis placed on financial assets. There is also the risk that claimants could restructure their asset portfolio immediately prior to making a claim, in order to ensure that their net financial wealth dipped below the suggested £250,000 threshold.

Question 17

Do you think we should be making any other changes to eligibility and/or the circumstances where we would make a payment?

Yes

If yes, please set out your suggestions and reasons for the change.

Payments from the Compensation Fund are already discretionary.

The SRA should be able to refuse to make payments, or to make smaller than requested payments, in respect of claims which appear to be unmeritorious, particularly where there is an element of culpability or 'contributory negligence' on the part of the claimant.

The SRA discusses the position of dubious investment schemes later in the consultation document, and we agree that the Compensation Fund should not make payments to disappointed or defrauded investors, simply because a solicitor was involved at some point in the process. There should have to be a link between the default of the solicitor and the claimant's loss. With regard to investment schemes, there should be an expectation that an investor obtains appropriate advice from a suitably qualified financial advisor or other expert in the type of proposed investment.

Question 18

Do you think we have set out the right approach for assessing when a maximum payment has been reached?

No

If no, please explain why.

We think it important to recognise that the Compensation Fund is intended to protect law clients from dishonesty and/or under/lack of PI insurance. We think the £500,000 cap is arbitrary and is unlikely to be accepted by the Legal Services Board, Parliament or the media, who will regard this as an attempt by 'fat cat' lawyers to avoid their responsibility to victims of unacceptable behaviour/incompetence by fellow members of their profession. As in insurance, the many pay for the few.

We also think it more likely that the SRA's PII proposals will result in more claims (for under- or no-cover insurance) than at present, as the insurance protection for the vulnerable wronged client will be sharply reduced.

It is difficult to see (from the quoted examples) on what basis the clients should suffer losses of c.£500,000 (example 1), £300,000 (example 2), £500,000 (example 3) and £400,000 (example 5) when the losses were not caused or contributed to by the *bona fide* clients/beneficiaries. We think the SRA's time would be better spent educating vulnerable firms on business management and competence (cover and indemnity levels) and policing them for signs of possible dishonesty within the business.

Question 19

Do you think the current formula remains a fair way to apportion the costs of maintaining the Compensation Fund?

No

If no, please explain you answer and any suggestions you have for alternative approaches

As we have just commented, the Fund (as with insurance) operates on the basis that 'the many pay for the few' losses caused by dishonest or incompetent law firms. It is not possible to protect against dishonest acts by individuals, which is usually prompted by greed or financial mishap, sometimes both. Either the profession as a whole accepts responsibility for the losses caused by the (thankfully) small number of dishonest/incompetent law firms or it does not. A 'half-way house' as suggested by the SRA is not satisfactory. We should add that the Fund has considerable discretion at its disposal and we regard this as a better way of

dealing with the problem than imposing arbitrary limits which are likely to cause public outrage.

Question 20

What steps do you think might be reasonable for someone to take to investigate a scheme/transaction before committing money to it and that it is genuine?

In our view the claimant on the Fund should show that independent professional financial advice was obtained from an FCA regulated individual/firm before committing money to the investment scheme. In this way the Fund will be protected from cold-calling scam claims and/or the investor will have rights of recovery from the IFA and/or FSCS. It occurs to us that this is the level of discretion that the SRA can (and should) be adopting now.

Question 21

Do you think setting out clear Guiding Principles in the rules or as guidance could make the purpose and scope of the Fund and how we make decisions clearer to users of legal services and their advisors?

Yes

Please explain your answer

Yes. It seems to us that the Compensation Fund already has set out reasonably clear explanatory notes on the current SRA (SCF section) website. If these can be improved/enhanced by Guiding Principles for the benefit/better understanding of potential claimants then we see no downside to this approach.

Question 22

Are there any positive or negative EDI impacts from the proposed changes to the Compensation Fund that you do not think we have identified?

If yes, please explain what you think these impacts are.

As indicated by the Law Society of England and Wales in its response, without a more detailed quantification of impacts, it is unclear.

Question 23:

Can you suggest any other approaches or strategies that the SRA might adopt to prevent firms being victims of cybercrime attacks?

As regulator, it is clearly important that the SRA has an effective communication strategy in place to ensure the profession is updated in a timely manner on cybercrime issues. If there are any significant cybercrime updates the profession needs to be aware of, we would suggest timely emails are sent to COLP's of all firms to help ensure the messages are communicated. The SRA may also wish to consider seeking the agreement of firms who have been the subject of a cybercrime attack, to allow the SRA to share the relevant details with the profession for the benefit of all. This could of course be done on an anonymous basis, depending on the facts.

This is one of the main risks affecting the profession today. We agree with the Law Society's suggestion in their response to this Consultation that developing a sector-wide approach (with the SRA and the Law Society working with the government and other relevant bodies) is a useful approach to try to combat cybercrime.

Cardiff and District Law Society

15th June 2018