

## **PROFESSIONAL INDEMNITY INSURANCE ANALYSIS OF CONSULTATION RESPONSES**

### **INTRODUCTION**

IPS issued a consultation on its proposal for Professional Indemnity Insurance and Compensation Arrangements on 27 July 2012. The consultation closed on 19 October 2012.

### **SUMMARY OF RESPONSES**

IPS published the consultation on its website in addition to alerting members and the public to it through the CILEx Journal. The consultations were also sent directly to CILEx members and organisations, including consumer bodies, regulatory and representative bodies.

The consultation received thirteen responses, ten of which were from CILEx members with the remaining responses from a regulator (in confidence), the Legal Ombudsman and the Legal Services Consumer Panel.

The responses were broadly supportive to the IPS approach to Professional Indemnity Insurance and Compensation Arrangements. The individual responses are attached with commentary by IPS.

<b>Q1. Do you have any comments that you would like us to take into consideration when drafting our minimum terms and conditions and minimum terms of cover?</b>
--

<u>RESPONSES:</u>
-------------------

<u>Self-employed CILEx Member</u>
-----------------------------------

‘Whichever insurance is used the minimum terms must protect both clients and applicants’
--

<u>Self-employed CILEx Member</u>
-----------------------------------

‘IPS should have regard to extending competition by facilitating the widest choice of legal services providers. IPS should proactively promote the development of micro and small business entities. £2 million is too high for small and micro entities. Even in residential conveyancing, transactions over £500,000 are rare. Small and micro entities would be paying for insurance cover they would never take up. The comment that lower premiums will be paid by lower risk entities is not relevant to the issue of the level of cover to be provided.’
---

Self-employed CILEx Member

'I still believe that £2million is very high. The future for immigration is very bleak with spiralling costs and a reduction in work we run the risk of being overcome by overheads with all of these proposals'.

Self-employed CILEx Member

'I currently have cover to £1million, as a new service provider, assessed on basis of not providing reserved activities. £2million minimum seems to me to be relevant for those practising reserved activities. Perhaps a two-stage would assist in the first instance'.

Self-employed CILEx Member

'Given the diversity of the practices that are likely to come into being I am inclined towards the open market insurance option as this is the only option that will provide a bespoke policy'.

**IPS COMMENTS Q1**

IPS carefully considered the open market and master policy schemes. A proportion of the responses to the consultations supported an open market approach. The research IPS commissioned through its brokers to analyse the most suitable arrangements of PII also favoured the risk based approach to regulation that the open market offered. IPS considers that the open market will remain the most competitive and fairest option for entities, whilst at the same time providing the client protection that is needed. IPS considers that a master policy may prove too restrictive as entities will be required to subscribe to an insurance policy that is not bespoke to their needs.

IPS is alert to concerns that the value of work that entities do will be low. It is also the experience of IPS from having regulated CILEx members and having visited immigration practices, that current members do not do high value work. Having discussed this matter in detail with insurance companies IPS has found that having different minimum levels of cover for different areas of law would not only complicate and hinder matters but may also increase administrative costs, resulting in increased premiums. Insurers advise that the premium payable by each entity will be adjusted according to the area of law the entity specialises in and the overall risks of the entity, and not the level of cover to which they subscribe. Therefore if an entity only does low risk/value work this will be taken into account when determining their premiums.

Self-employed CILEx Member

'Re your point 8 - I am just very uncertain how the level of risk will be calculated in these completely new business models. Is it possible for insurers to look at solicitors' records but since a CILEx individual or entity is likely to be a specialist in a particular area and their risk profile must be different to a solicitor who can do any sort of work but may not specialise in that area of

work'.

### Regulator

'The minimum terms and conditions must ensure that clients of regulated firms have adequate financial protection. We suggest that the key minimum terms and conditions should include:

- Cover for all civil liability arising from private legal practice, with only limited permitted exclusions.
- The "insured" should include the "entity" (and any prior practice) together with any current or former principal, employee or consultant.
- Cover should extend to the practice as a whole including any body corporate.
- Cover should extend to all activities permitted to an IPS regulated entity.
- Cover should be arranged on an "any one claim basis" with a minimum sum insured of at least £2 million any one claim.
- The minimum sum insured should be exclusive of defence costs which should be covered in addition without financial limit.
- The level of the excess should be limited or else insurers should be required to pay the excess where there is failure to pay by an entity with rights of reimbursement against the entity.
- In order to secure client financial protection, qualifying insurers should be prohibited from avoiding or repudiating the insurance on any grounds whatsoever including non-disclosure, misrepresentation and failure to pay premium (although they may be given rights of reimbursement against each insured)'.

### **IPS COMMENTS Q1**

IPS has considered these comments and worked with its broker and a leading insurer to develop Minimum Wording that each Qualifying Insurer must agree to as part of the IPS Qualifying Insurers Agreement. The Minimum Wording deals with all of the points raised above.

### Legal Ombudsman

'Research commissioned by us and published in November 2011 found that many consumers find accessing redress in legal services confusing as, depending on business model, some consumers have access to redress through

our scheme while others do not. We would not like to see further gaps in access to redress appearing; for example, some regulators adopt less comprehensive requirements for minimum terms and conditions for indemnity insurance than others. It should not matter who a firm is regulated by, consumers should be able to access the same remedy if there is poor service. In the interests of consistency, we would suggest mirroring the provisions made in the Solicitors Regulation Authority's (SRA) minimum terms and conditions of insurance. We would not wish to see a situation where CILEX chartered legal executives working within solicitors firms and CILEX members working in independent firms have differing levels of cover. One shortcoming in the SRA scheme is the lack of cover where the Ombudsman directs a refund of fees and the firm has ceased trading. The SRA does not require refunds of fees to be covered in these circumstances. While we appreciate the commercial reasons for not covering refunds of fees where the firm is still trading, it seems that the insured losses in respect of Ombudsman's awards against closed firms is likely to be small and quantifiable. We would therefore propose a clause which deals specifically with refunds in these circumstances'.

### **IPS COMMENTS Q1**

IPS has considered the above comments and understands these concerns. IPS has drafted Minimum Wording, Professional Indemnity Rules and is in the process of drafting a Qualifying Insurer Agreement to safeguard against the above. In relation to complaints and the refund of fees, IPS explored the position but advice indicates such matters will be too onerous to insure against.

### **Q2. Have we effectively dealt with run off cover? If not, why not.**

#### RESPONSES:

8 out of 13 responses indicated 'yes' and 3 indicated 'no' and 2 gave 'no indication'.

#### Self-employed CILEx Member

'Run off cover is important but I think personally that this should be included within the premiums of the policy from the outset, and after so many years you automatically get this.'

#### Self-employed CILEx Member

'Yes but greater certainty would be provided if all regulated entities were required to have a master policy providing standard run off cover. Administration by the regulator would be simplified by a master policy scheme which would keep basic regulation costs low'.

### **IPS COMMENTS Q2**

IPS will periodically re-visit its approach to run-off cover to establish whether minimum wording as suggested can be adopted.

Self-employed CILEx Member

'I could not see any reference to a minimum period for run-off cover'.

CILEx Member Ltd Company owner manager

'I consider that a minimum period of six years after an entity ceased to practice is excessive. 3 years may be adequate'.

Regulator

'It is not possible to regulate firms to buy run-off cover after they cease, and the only way to effectively achieve this is to impose the obligation on the insurers, whether under a Master Policy or a Qualifying Insurer's Agreement in respect of freedom of choice. In paragraph 10 of the consultation document IPS proposes that "...where entities decide to cease practising they will have to take run off cover for a minimum of six years." Placing the obligation on the entities to take out 6 years run off cover runs the risk that the market will not be prepared to provide such cover particularly to firms that have a claims history. This, in turn, will put claimants at risk of having valid claims firms not satisfied'.

Self-employed CILEx Member

'Law Society guidance last year suggested that the period of limitation of liability in Probate matters may be at least 12 years or possibly 13 years on basis that the right to claim may arise at the end of the Executor's year 1 year from the date of death. However all usual run off periods are 6 years so this may be an academic point. Run off cover is essential.'

Legal Ombudsman

'Yes, however there are issues around ensuring that run-off cover is in place when a firm ceases trading. Not all cessations are done in an orderly fashion with planning and structured decision making. We would like to know how this would be dealt with. See below question 3 and our suggestions'.

NOTE: IPS has set out its response to the above as part of its response to Q3. Below

**Q3. What are your views on how we can ensure that entities regulated by IPS will take run-off cover on the Open Market when they cease practising?**

Self-employed CILEx Member

'It is not clear to me how IPS can ensure this save for requesting sight of

indemnity policy on an annual basis. If IPS are regulating a number of entities this could become onerous: time consuming and costly. A Master Policy might be the better option'.

Self-employed CILEx Member

'I would suggest the IPS begin relationships with insurers on the open market to encourage them to include this as a standard for ILEX regulated bodies'.

CILEx Member Ltd Company owner manager

'To make run-off cover compulsory'.

Regulator

'It is the regulators view that the key to ensuring that entities regulated by IPS will have run off cover on the Open Market when they cease practising is to place an obligation on qualifying insurers to provide such cover. This can be achieved by making it a term of the qualifying insurer's agreement referred to in paragraph 20'.

CILEx Member Ltd Company owner manager

'IPS could ensure that they sign some form of contract to safeguard IPS interest'.

Self-employed CILEx Member

'This needs to be built into the guidance on practice management and terms drafted upon overall regulation of entities'.

Self-employed CILEx Member

'Make sure they have to provide evidence of their PII insurance confirming run off cover within a certain period of their practising certificate being renewed. Get them to sign to say they have cover in place and ask them for evidence of their cover to be sent, say within 3 months of the start of the policy period'.

Self-employed CILEx Member

'This is always going to be a difficult task particularly during uncertain economic times. Would it be possible for entities to have a subordinated loan account into which appropriate funds were lodged whilst the company was running and which would remain in place once they ceases practising to provide for run-off cover?'

Legal Ombudsman

'Our experience shows us that there are a small number of firms which cease trading in a disorganised manner, such as when the practice is abandoned or faces compulsory insolvency. In these circumstances, there is significant scope for consumer detriment if run-off insurance is not in place. Since a firm which has ceased trading will usually be beyond the scope of disciplinary action, and since those responsible for it may well be exiting the market in any event, it is

difficult to see how disciplinary rules can effectively require firms to take out run-off cover. Given the above, it is our view that measures will need to be taken to ensure that run-off cover is automatically provided by indemnity insurers in the event that a firm ceases trading. For that reason, we would suggest that a "fall-back" Master Policy be put in place to cover such scenarios.'

### **IPS COMMENTS Q2 & Q3**

IPS is aware of the difference in views expressed by respondents and the balance it needs to achieve when considering the length of run-off cover that entities must subscribe to. IPS decided that in the interest of consumers a policy of six years run-off cover must be adopted to achieve parity of consumer protection with other approved regulators. This obligation will be placed upon entities through the Professional Indemnity Rules. In addition the run-off premium has been set at 2.25 times the amount of an entity's last annual PII, which is lower than other regulators, and entities will not have to pay an excess on claims during the run-off period. Insurers were unable to provide automatic run-off cover except where an entity pays the run-off premium. Entities should be able to obtain finance to help breakdown the costs of run-off cover. Insurers have also agreed to provide an Extended Indemnity Period of insurance, which comprises a 30 day Extended Indemnity Period where an entity can continue to practise and an additional 60 days in which the entity will have to close their practice and take run-off cover.

IPS will protect clients where an entity has not obtained run-off cover. Clients will be protected as claims arising where there is no cover will be dealt with through the IPS Compensation Fund.

### RESPONSES:

#### Self-employed CILEx Member

'Build it into the premiums so for example – if you hold PII for 10 years, you are automatically covered by the run off you will need'.

#### Self-employed CILEx Member

'IPS should provide a master policy with minimum standards of cover. Regulated entities would be able to add to basic cover by topping up the policy on the open market. A master policy arrangement would help to foster small and micro entities. The advantages of a mater policy are – The pooling of risk to minimise premiums, Reduced administration for regulated entities and for the regulator. An entity wishing to withdraw from the master policy entirely could only do so if they are able to demonstrate cover at least as good as the master policy and pay an additional administration fee to the regulator. Too much emphasis has been placed on the perceived wishes of larger entities to achieve cost effective insurance rates whereas the focus should be on providing a means of access to basic indemnity insurance for IPS regulated entities as whole and smaller entities in particular. The underlying purpose of

the LSA is to widen access to justice and to foster competition in legal services. The objectives of the legislation are more likely to be achieved by encouraging a diverse range of different types of regulated entities varying size, specialisation and ambition. Insufficient weight has been given to the benefits of the pooling of risk and economies of scale offered by a master policy'.

### **IPS COMMENTS Q3**

IPS has carefully considered these comments and will periodically re-visit these points. Having carefully explored the options IPS is of the view that open market insurance is the most suitable provision and does not consider that the open market advantages larger practices more than smaller practices.

**Q4. It is our preferred option that entities regulated by IPS will have to obtain PII on the Open Market. Do you think we have adequately addressed the issue of the Open Market? If not, please identify areas that we need to consider further.**

#### RESPONSES:

9 out of 13 responses indicated 'yes' and 3 indicated 'no'.

#### Self-employed CILEx Member

'IPS should outline recommendable companies still to applicants. Companies are only good if they are prepared to do what they say if the worst was to happen'.

### **IPS COMMENTS Q4**

IPS is unable to recommend one insurer over the other. However, insurance will have to be obtained through a Qualifying Insurer who has agreed to the IPS Qualifying Insurers Agreement. Details of such insurers will be provided to entities.

#### Self-employed CILEx Member

'No, IPS should offer a master policy but allow entities to obtain their own top up cover.'

#### Self-employed CILEx Member

'I do not agree that the Open Market is necessarily the better option. There have been problems for law firms with the Open Market since the Law Society discontinued its Master Policy. If IPS were regulating entities with no former track record insurance on the Open Market could prove prohibitively expensive: thus a Mater Policy might be the better option. It would enable IPS to be confident that the level of cover was adequate and appropriate and would probably be more cost effective.'

Self-employed CILEx Member

'I agree that the open market is preferable, however, the IPS should review this stand point periodically. If they feel entities are struggling to find the appropriate cover it may be in the best interest of all concerned to provide a master policy option.'

Regulator

'Mandating that IPS regulated entities must obtain PII from a qualifying insurer presupposes that there will be a market willing to write the cover. We would suggest that IPS need to take steps to minimise the risk that the market will not be interested in providing such cover. For example appointing insurance advisors to help with negotiations with insurers with a view to getting a handful of insurers signed up and committed to the terms of the Qualifying Insurer's Agreement and the minimum terms and conditions. One of the advantages of a Master Policy is that it would address the problem.'

Self-employed CILEx Member

'I suggest that you make an easy to understand premium calculation one of the conditions to be a qualified insurer. Personally I feel that basing the premium on net available income is a fairer way of doing it. My business expenses sometimes total 50% of my turnover so basing premium on turnover does not reflect affordability for the individual or entity.'

**IPS COMMENTS Q4**

Initial indications from the IPS broker suggest that there is a variety of insurers who are interested in insuring IPS regulated entities. Insurers seem particularly interested in the IPS competence and relationship management to risk based regulation. IPS will therefore be mandating that regulated entities must obtain PII from a qualifying insurer, who in turn must agree to the IPS Qualifying Insurers Agreement. IPS has taken all of the above issues into consideration before pursuing the open market approach. IPS has drafted its rules to help facilitate this approach and protect consumer interests.

**Q5. Do you think our proposals for PII will provide sufficient client protection? If not please tell us why not.**

RESPONSES:

7 out of 12 responses indicated 'yes' and 5 gave 'no indication'.

Self-employed CILEx Member

'Client protection is important but companies/applicants should also be protected, especially in probate matters as we live in a contentious world.'

Self-employed CILEx Member

'No. Greater protection will be provided by a master policy. Some small entities might have a problem meeting minimum excesses amounts. Consideration should be given to providing additional excess cover for small entities or such excesses should be underwritten by the regulator or CILEx.'

Self-employed CILEx Member

'I am not sure that it will: as indicated above I do not consider the Open Market is necessarily the better option.'

Self-employed CILEx Member

'As long as run-off cover is obtainable.'

CILEx Member Ltd Company owner manager

'Yes, but the requirement for additional insurance cover should be reconsidered.'

Regulator

'It is difficult to say without seeing the precise terms and conditions of the cover which insurers will be required to provide. We believe it is reasonable to assume that if insurers regard the IPS regulatory regime as satisfactory then, given the activities are those which insurers are accustomed to covering at the present time, there should at least be some market and on broad terms, absence some of the unique features mentioned in answer to question 1. We believe that if the points made in answer to questions 1 to 4 are addressed then there is no reason why the IPS proposals cannot be modified so as to provide sufficient client protection.'

Self-employed CILEx Member

'It seems to me they do provide sufficient client protection as they will be similar to what solicitors have had for many years. If we are not covered as well as solicitors for PII they will still be able to gain an economic advantage over CILEx practitioners by saying that only their work is best insured. The idea is we will be on a level playing field with solicitors so we must have at least the same level of PII cover both to protect the public and for this reason also.'

Legal Ombudsman

'We cannot say at this stage. It is important that the minimum terms and conditions cover as much of each order for redress the Legal Ombudsman makes, as is commercially possible, and we highlight the issues of refunds of fees involving closed firms in that regard. There is also, as we have pointed out above, a potential issue with the run-off cover in circumstances where firms close in a disorganised manner.'

### **IPS COMMENTS Q5**

IPS took all of the above issues into consideration before pursuing an open market approach. The rules IPS has drafted facilitate this approach and help protect consumer interests. Insurers have been advised about the competency and risk based approach to regulation that IPS is taking. They are also fully aware of IPS' core obligation of consumer protection. A variety of insurers have confirmed that they are prepared to insure IPS regulated entities and to adopt the Minimum Wording prescribed by IPS, which shows their satisfaction in the IPS regulatory regime.

### **Q6. Do you have any other comments on the PII proposals? If so, please state what they are.**

#### RESPONSES:

#### Self-employed CILEx Member

'Premiums need to be reasonable for sole practitioners and small firms.'

### **IPS COMMENTS Q6**

IPS has been working (and will continue to work) with insurance companies to help entities obtain the most competitive premiums. Insurers have been advised about the competency and risk based approach to regulation that IPS is taking they have also been made fully aware of IPS' core obligation of consumer protection. A variety of insurers have confirmed that they are prepared to insure IPS regulated entities.

#### Self-employed CILEx Member

'Entities should be required to give full details of PII in all engagement letters, including policy number, level of cover, excess, name and address of insurer and significant limitations.'

### **IPS COMMENTS Q6**

The requirement to provide insurer details is contained in the IPS Professional Indemnity Rules. IPS will also require entities to follow regulation 8(1)(n) of the Provision of Services Regulations 2009, which prescribes similar requirements.

#### Self-employed CILEx Member

'I consider that a Master Policy would be the better option at least for the first (5 or 10) years when IPS are regulating entities. Some of these entities will be new and entity regulation will be new for IPS. Thus a Master Policy would ensure that there was appropriate indemnity cover for all entities in order to protect the client (consumer). This could be review after an initial period.'

**IPS COMMENTS Q6**

IPS believes that the open market will provide the best possible protection for consumers. This decision has been made following research and advice into the options. However, IPS will periodically review its approach to PII and make any adaptations where necessary.

Regulator

'We believe IPS need to consider what will happen if an entity is unable to obtain PII on renewal? How will clients be protected in the event that they have claims against an entity that is practising without PII?'

**IPS COMMENTS Q6**

IPS has considered this possibility and has included a provision within the Minimum Wording and Qualifying Insurance Agreement for insurers to provide an Extended Indemnity Period of insurance, which comprises a 30 day Extended Indemnity Period where an entity can continue to practise and to obtain qualifying insurance. After this time the entity will enter a cessation period of 60 days in which they will be unable to accept new instructions and will only be allowed to perform work in connection with existing instructions. It is envisaged that in total the 90 day period will provide IPS enough time to investigate why the entity has not renewed their insurance policy. Any claims arising where an entity has ceased practising but has failed to secure run off cover will be considered under the IPS Compensation Fund.

CILEx Member Ltd Company owner manager

'I already have PII in place and the amount covers the low risk cases from my firm proposes, as the PII already ask a series of questions before they provide cover.'

**IPS COMMENTS Q6**

IPS envisages that obtaining PII on the open market in the future will involve a similar process to that mentioned above.

## COMPENSATION ARRANGEMENT CONSULTATION

### Please Note: IPS RESPONSE

Many responses to each of these questions overlap. IPS has provided overall comments at the end of this document. In providing its comments IPS has taken into consideration all of the responses made to this consultation.

#### Q7. Out of escrow, Compensation Fund and Insurance policy, what is your preferred option and why?

##### RESPONSES:

##### Self-employed CILEx Member

'escrow would be too expensive for small businesses to use. Insurance policy seems to be my preferred option as it seems a more reasonable way to deal with things however it does depend on premium amounts. The compensation fund could end up where the honest people that do pay into it will end up funding the dishonest people.'

##### Self-employed CILEx Member

'Client Protection is inextricably linked with the conduct by regulated entities of transactions involving client money. Regulated entities should be free to choose the means of conducting financial transactions on behalf of clients that suit them and their clients and the transactions they carry out and that consequently the IPS response to client protection safeguards should be flexible enough to reflect the different approaches that may be adopted. Regulated entities may choose a number of different options:

- Not to conduct any transactions involving client money
- To operate a full client bank account
- To employ an escrow agent for transactions involving client money

Moreover Regulated entities might wish to join together to share services that provide Client Protection. Available services should include escrow services. An escrow service offers:

- Reduced administration
- Reduced compliance overhead
- Better risk management
- Greater credibility

An escrow service could offer commercial advantages to IPS regulated individuals through reduced overheads, increased credibility with commercial lenders and a lower risk profile of the business and therefore cheaper insurance premiums. Entities who may specialise in litigation or whose turnover is small may have little or no need to regularly hold any transfer client funds and may well prefer an escrow account where the cost per transaction

might be payable by the client in any event or where it would be offset against lower overheads if not. Escrow services are commonly used in other jurisdictions and are increasingly familiar to the general public through their use in online auction sites. The cost of escrow service quoted seems unreasonably high. Escrow services are available to retail customers from £3.00 per transaction. It is likely that transaction fees to properly regulated commercial client, would reduce substantially and the cost of operating an escrow service may be significantly less for smaller entity than the cost of employing a cashier. An escrow service would offer a smaller entity a reduced compliance overhead, with, in effect, compliance with Client Account Rules outsourced to the escrow service. Escrow service would have to be approved by IPS, and now must be regulated as Payment Service by the FSA. Similar benefits to an escrow service would be afforded by two or more regulated firms joining together to share Client Account facilities. For instance Firm A might be regulated by the SRA and might offer Client Account Facilities on an agency basis to Firm B, regulated by IPS. The sharing of resources would be efficient and would support the maintenance of high standards. IPS should offer the choice to regulated entities to provide their own client account facilities provided that the regulated firms can demonstrate satisfactory compliance with Accounts standards. IPS should consider the cost of maintenance, in addition, a master client protection insurance policy which should reflect the individual risk of each regulated entity taking into account the option for the conduct of transactions involving client money that the entity adopts.'

Self-employed CILEx Member

'Insurance. It will reduce financial risk to IPS/CILEx, ensure fair premiums to entities based on risk and protect the client (consumer).'

Self-employed CILEx Member

'Although it is dependent on likely premiums/contributions. I would suggest a compensation fund would be preferable as a Fund could be built over time which could conceivably limit cost to entities in the longer term.'

CILEx Member Ltd Company owner manager

'Insurance policy, if it is considered that PII is not sufficient.'

Regulator

'It is difficult to imagine that the profession would have sufficient financial resources to establish a Compensation Fund without recourse to whole or partial insurance. We are advised that commercial coverage is available for the risks associated with misappropriation of client funds. The escrow account idea undoubtedly reduces some of the risks but other exposures to client funds remain which would still require the purchase of some insurance protection.'

CILEx Member Ltd Company owner manager

'Insurance policy very straight to the point everybody knows what has to be

paid out in terms of dishonesty/failure to account.'

Self-employed CILEx Member

'Insurance most efficient means of meeting short and long term cover. Fairer assessment of means for smaller i.e. sole practitioners and none client fund holders. Opposite to escrow – too costly. Compensation Fund – undesirable and ultimately costly.'

Self-employed CILEx Member

'I am keen on escrow if the cost can be brought to an affordable level, £12 per transaction is not affordable. I did say at Reference Group on 05.10.12 that perhaps you should tell those you are consulting that the cost is coming down as it may affect their responses. £4 or so is much better but probably still not low enough. If we can convince the escrow agent that there will be plenty of transactions perhaps they will bring the cost down further. Alternatively I am in favour of an additional Insurance Policy if Escrow cannot be afforded. I wonder if escrow is a bit of overkill. Most lawyers are honest and would probably not need quite that level of client protection.'

Self-employed CILEx Member

'Insurance policy – in those circumstances it would not be necessary to incur significant fees per transaction (with escrow) and nor does a fund need building up which would be difficult to achieve in the early stages and could lead to economic hardship for new entities.'

Legal Ombudsman

'Escrow would be the preferred option because it removes the firm from the handling of client money, and therefore significantly reduces the risk of improper deductions from client funds. This would also mitigate the issue with refunds of fees identified in question one above.'

**Q8. It is our view that an Insurance policy provides the most suitable mechanism for compensating clients. Do you think that an Insurance policy would adequately protect clients' interests in the event of dishonesty and/or failure to account? If not, please identify areas that we need to consider further.**

RESPONSES:

9 out of 13 responses indicated 'yes' and 3 indicated 'no indication'.

Self-employed CILEx Member

'IPS should provide both a compensation fund and insurance policy. A one off levy on CILEx should be made to endow the compensation fund in its first year.'

Regulated individuals should pay a levy each year to the fund. Some mechanism to positively reward regulated entities with a good claims record such as a modest rebate scheme in the absence of any complaint (whether or not involving any financial claim) should be adopted to reinforce best practice. An insurance policy should be taken out the cost of which would be met by a levy on the Practice Fee. The insured sum should be for the minimum level of cover thought appropriate less the value standing to the credit of the compensation fund. Over time the payments into the compensation fund would hopefully drive down the insurance premium. In the early years the insurance element of the fund may dominate but over the years a good record will increase the compensation fund and reduce the need for insurance and the consequent cost to IPS regulated individuals.'

#### Self-employed CILEx Member

'Provided the terms and conditions are properly negotiated and agreed. However, what would happen if an insurer were able to refuse indemnity e.g. for material non-disclosure? Would there need to be a compensation fund to provide compensation in the event of an insurer refusing to indemnify?'

#### Self-employed CILEx Member

'An insurance policy may well cover the needs of the client however it may not be the most economically efficient way for entities to provide security for them'.

#### Self-employed CILEx Member

'Insurance should provide sufficient client protection so long as insurance company itself is secure. Will it be OK for me to stay with Hiscox if they are qualifying insurers and provide minimum terms which I hope they already do?'

#### Legal Ombudsman

'An insurance policy would probably be better than a Compensation Fund, given the funding issues and the uncertainty around the potential value of claims. If CILEX is successful in its bid, it is likely that the number of independent legal executive run firms will increase. It is difficult to anticipate how the market will work in terms of scale, how it will fit in with existing legal services providers and what work independent firms will carry out. In view of these issues, it is not easy to see how in practical terms an effective compensation fund could operate. An insurance policy, at least initially, would seem like a better option as it would be better able to deal with uncertainty and the risks associated with uncertainty. However, this is not to say that this should not be reviewed in the future once there is more certainty regarding the market Chartered Legal Executives are working within. It may well be that in the medium to long term a compensation fund would be appropriate.'

**Q9. Do you think our proposals provide sufficient Client Protection? If not, please state why not.**

Self-employed CILEx Member

'Yes – you have done very well here to provide sufficient client protection.'

Self-employed CILEx Member

'Greater emphasis should be given to delivering the aims of the LSA to encourage competition and to improve access to justice. The latter will be achieved by lowering the cost of legal services. It is therefore vital that at all times, the cost of regulation is a central factor in the design of the Client Protection scheme.'

Self-employed CILEx Member

'Yes, provided the situation I have flagged up at 8 is clarified [*Question 8 - Provided the terms and conditions are properly negotiated and agreed. However, what would happen if an insurer were able to refuse indemnity e.g. for material non-disclosure? Would there need to be a compensation fund to provide compensation in the event of an insurer refusing to indemnify?*]

Regulator

'It is difficult to comment at this stage but we believe your proposals are capable of providing sufficient compensation arrangements to protect clients in the event of dishonesty or failure to account by entities you regulate.'

Self-employed CILEx Member

'I think they do provide very good protection. Please remember that some practitioners such as myself do not hold Client funds. I arrange for the Executor to open an Executors' account with a High Street bank of their choice and while I advise on which cheques should be drawn and give directions as to transfers to be made I do not have ultimate control over the account the Executor does. I am not a signatory on the account for example. Please advise whether it will be OK for me to continue with this arrangement for Probate matters. Also I think we should have succession arrangements in place in case of death of our permanent mental incapacity or in case of a temporary health or other difficulty we have agreed with another suitably qualified member that they will handle our matters to completion to the satisfaction of the client.'

**Q10. Do you have any other comments on our Client Protection Scheme?  
If so, please state what they are.**

Self-employed CILEx Member

'The best protection for the general public is the maintenance of high standards within the profession and the efficacy of regulation. Regulation must bear in mind at all stages of planning and implementation the cost of compliance both in terms of expenditure but also in management time. Therefore the scheme should be designed to keep expenditure as low as possible rather than emulating existing regulatory arrangements.'

Self-employed CILEx Member

'I consider a Master Policy might be better option for an initial period. I also have concerns on potential refusal of indemnity for e.g. material non-disclosure and where that would leave the client (consumer) IPS/CILEx.'

Self-employed CILEx Member

'I would be opposed to an Escrow agent as this appears to involve an inordinate level of upheaval for entities in rearranging their financial models.'

Self-employed CILEx Member

'Re your point on insurance rules, do also make sure that the complaining client must also act truthfully, honestly and with integrity when making a claim since there are some clients who like nothing better than to take advantage of an insurance policy for financial gain.'

Legal Services Consumer Panel

'IPS has considered various options for client protection, including an Escrow, a compensation fund and an insurance policy. However, assessment of the advantages and disadvantages of these options seems to have been carried out from the perspective of providers not consumers. For example, the fact that entities would face an added layer of control on the transfer of funds from an Escrow is listed as a disadvantage yet the Panel considers this would be a positive advantage for consumers. The Panel believes the option of an Escrow rather than an insurance policy may be optimal for consumers.'

We note that the Escrow costs are estimated at £12 per transaction and that these charges could be unsustainable. However, it is difficult to make a definitive comparison on this as there is no other information on the likely costs of each option. Furthermore, we note the costs of the preferred option (insurance policy) have not yet been worked out which somewhat undermines the argument put forward for favouring this alternative.'

**IPS COMMENTS**

IPS has considered the comments carefully. IPS is alert to the comment made by

the Consumer Panel on escrow and the difficulties in comparing and considering the transaction fee of £12 in isolation. IPS has continued to discuss escrows with the agent they are working with, further negotiating a reduction in the transaction fee. Having considered the comments above IPS wants to provide a flexible mechanism of client protection that will take into account the needs of clients and entities. The regulatory arrangements that IPS is adopting will therefore allow entities the option of putting in place an escrow arrangement.

IPS considers that there will always remain the need for a Compensation Fund for the purposes of making grants to persons who have suffered loss by reason of the dishonesty of an IPS regulated entity and making grants to applicants who have suffered hardship as a consequence of a failure by an IPS regulated entity to account for money. Grants will be made at the discretion of IPS and the fund will be maintained through entity contributions

Whilst the fund is being built and to help protect consumers IPS has been working with an insurance company who has agreed to provide insurance that will cover claims made on the Compensation Fund. The premiums for this insurance will be broken down into the IPS regulatory costs/Compensation Fund contributions.

IPS wants to give the entities that it regulates the choice of utilising the escrow.

By providing the above options IPS is of the view that entities will be able to adopt procedures that are most suitable to their needs, whilst at the same time not compromising client protection, which is of paramount importance to IPS.