Cover story

Julian Chamberlayne and **Catriona Abraham** on new insurance rules affecting lawyers

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The Solicitors Regulation Authority implemented the EU-wide Insurance Distribution Directive last year. The breadth of the revised rules, which are backed by criminal sanction, means that law firms need to be aware of the changes even if a firm has limited involvement in arranging insurance for their clients.

Furthermore, under Chapter 1:Outcome 1.5 of the SRA Code of Conduct, solicitors have an obligation to advise clients on funding options. The importance of this is highlighted by cases such as *Adris v Royal Bank of Scotland Plc* [2010] EWHC 941 (QB), in which it was held that a solicitor is under a duty to advise its clients on the availability of after-the-event insurance (ATE). The rise of professional negligence cases is marked by an ever increasing number of firms that are marketing their services for claims against solicitors concerning cost and funding issues. This article highlights the key factors that firms should consider.

The revised SRA Conduct of Business and Financial Services (Scope) Rules came into force in October 2018 and implemented the Europe-wide Insurance Distribution Directive [2016/97] for solicitors. With SRA guidance only being available from 27 September (two business days before the implementation date), the changes relevant to ATE seem to have caught some law firms, insurance providers and brokers by surprise.

Stewarts has taken a proactive role in engaging with the SRA on these changes, through our substantive consultation reply and reviews of the rule changes. Below are the key questions we believe that law firms should be considering.

INSURANCE RULES

1. Is your firm an ancillary insurance intermediary and do you carry out insurance distribution?

'Ancillary insurance intermediary' and 'insurance distribution' are new terms introduced by the rule changes, which firms should become familiar with. A number of activities are included in the definitions, meaning that even a firm that is simply pre-completing insurance policy documents for clients will be captured under the revised rules.

The best way to determine whether these terms are relevant is to read the definitions, which can be found in Art 2.1(4) Directive (EU) 2016/97 and in the Financial Conduct Authority (FCA) Handbook, respectively.

As with the old regime, firms continue to carry out these activities as an 'Exempt Professional Firm'. This means firms are regulated by the SRA but must also:

- give notice of the firm's intention to carry out insurance distribution activities to the SRA; and
- register as an Exempt Professional Firm with the FCA.

Firms will, however, have to update their terms of business and other regulation notices to reflect the new terminology (see SRA Conduct of Business (COB) Rule 3).

2. What is a 'personal recommendation' and what are the firm's obligations when providing one?

Before 1 October 2018, law firms were usually either 'arranging' or 'recommending' insurance products. Now, firms are either 'recommending' or 'personally recommending' insurance products.

However, the wide definition of 'personal recommendation', as below, brings a higher level of accountability of the firm to their clients and to the SRA when proposing insurance products.

A personal recommendation is 'a recommendation that is presented as suitable for the person to whom it is made or is based on a consideration of the circumstances of that person.' (See SRA Glossary of New Defined Terms.)

In keeping with the old regime, firms are still required to:

- provide the client with a demands and needs statement; and
- ensure the firm communicates in a 'clear, fair and not misleading' way.

However, if a firm is making a 'personal recommendation', as will often be the case, they now must also:

- ensure any personal recommendations are made 'on the basis of a fair and personal analysis' (SRA COB Rules, Appendix 1, 3.1(a)); and
- provide a 'personalised explanation of why a particular contract of insurance would best meet the client's demands and needs' (SRA COB Rules, Appendix 1, 4.4).

The above points are the key obligations that firms should bear in mind when training their employees and communicating with clients. Firms cannot simply rely on static template documents for all clients and will often need to personalise their ATE analysis and the demands and needs statement for a client's individual circumstances.

3. What is an IPID and to what extent is the firm responsible for its content?

Under the new rules firms must provide a new document, called an Insurance Product Information Document (IPID), to all 'individuals … acting for purposes which are outside his trade or profession' for each policy, (SRA COB Rules, Appendix 1, 13.4). This will, therefore, apply to a wide range of individual clients, but not to corporate entities.

The IPID is to provide 'objective and relevant information' so that the client can make an 'informed decision' (both SRA COB Rules, Appendix 1, 13.1). In its guidance, the SRA further commented that 'the [insurer] is required to draw up the IPID and must set out the key information a client will need to make an informed decision about the product'.

In practice, this document closely resembles the policy summary that most insurers or brokers provided under the old regime. The onus is on the insurers and brokers to produce the document, but what is important for law firms to note is that lawyers have an obligation (whether providing a personal recommendation or not) to ensure that the IPID contains 'objective and relevant information' and that 'the level of information provided takes into account the complexity of the policy and the individual circumstances of the client.' (SRA COB Rules, Appendix 1, 13.3.).

4. What are the grey areas to watch out for?

Litigation firms should be providing input to insurers and brokers so that policies are appropriately tailored to clients' needs. However, firms must be careful not to stray into 'creating, developing, designing and/or underwriting… contract[s] of insurance', which is now prohibited under the SRA Scope Rules, 3.1(w).

Also beware that the SRA's definition of 'personal recommendation' differs from the FCA's definition; and so insurers or brokers may be hesitant about using the term to avoid ambiguity.

As mentioned, the SRA COB rules dictate that a firm's personal recommendation should be made on a 'fair and personal analysis'. Further, this analysis must include 'analysis of a sufficiently large number of insurance contracts on the market' (SRA COB Rules, Appendix 1, 3.2(a)).

As Stewarts highlighted in its reply to the SRA consultation, the reality is that law firms often delegate this level of analysis to third-party insurers or brokers. It makes sense that law firms rely on the specialised insurance market surveillance of third parties rather than replicating that in house at greater cost to the client. However, this is an issue that the SRA is yet to address.

5. What is the penalty for a breach?

Under the SRA Scope Rules, 6, if a firm breaches the rules the firm may be committing a criminal offence under s23 Financial Services and Markets Act (FSMA) 2000. However, as discussed above, any breach may also give rise to professional negligence liability.

The High Court judgment in *Adris v Royal Bank of Scotland Plc* was later considered by the Court of Appeal in *Heron v TNT (UK) Ltd* [2013] EWCA Civ 469. The appeal was dismissed as the defendant employer had failed to show that the claimant's solicitors were liable to a non-party cost order. However, Lord Justice Leveson's judgment (in particular paragraphs 27-30; 36-39) detailed the claimant's solicitors' failure to advise the claimant about ATE insurance, and supported that such a failing would likely give rise to a conflict of interest and amount to professional negligence.

6. So why should firms bother with recommending insurance to clients at all?

Following the Legal Aid, Sentencing and Punishment of Offenders (LASPO) Act 2012, ATE premiums are no longer routinely recoverable from a losing defendant. There were predictions that the industry might see the end of ATE altogether. However, clients generally remain relatively risk averse, and welcome the security that insurance policies provide. In our experience, that even applies to clients with serious injury claims who are covered by qualified one-way cost shifting (QOCS), due to its caveats, and the fact that without ATE, those clients are at risk in relation to their own disbursements.

Having a sound understanding of the insurance distribution regulatory obligations placed on law firms is a necessary part of the legal service they provide. The importance of this is emphasised by the risks associated with non-compliance (potential criminal sanction, disciplinary action by the SRA and/or civil action from clients). Therefore, if your firm does not have the expertise to deal with this in house, it would be wise to establish a relationship with a good broker to help guide you. But beware of the blurred lines between the obligation of the law firms and that of insurers and brokers.

7. But what about Brexit?

A draft version of the Insurance Distribution (Amendment) (EU Exit) Regulations 2019 was published on 19 December 2018. This legislation ensures that the Commission Delegated Regulations (EU) 2017/2358 and (EU) 2017/2359 are fully implemented into UK law in preparation for UK's exit from the EU. This, therefore, has little to no effect on a firm's insurance related regulatory requirements.

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