

SRA BOARD
14 September 2021

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This paper will be published

Post consultation update on proposal to clarify the scope of cyber cover in Professional Indemnity Insurance (PII)

Purpose

- 1 This paper reports on the outcome of our consultation on the Minimum Terms and Conditions (MTCs) for solicitors' Professional Indemnity Insurance (PII) arrangements to clarify the scope of cover when a law firm has been subject to a cyber-attack/computer breach.
- 2 We received a varied range of views to the consultation and this paper sets out our response to the issues raised and asks the Board to agree to a slightly revised wording to the clause on which we consulted.

Recommendations

- 3 The Board is asked to:
 - (a) agree our response to the consultation set out at paragraphs 21-24
 - (b) make the amendments to the MTCs set out in annex 2.

If you have any questions about this paper please contact: Tracy Vegro, Executive Director, tracy.vegro@sra.org.uk

Equality, Diversity and Inclusion considerations

Consideration	Paragraph no's
These changes are for clarification only and do not change the scope of cover provided by our insurance arrangements. We have not identified any EDI considerations from these changes	

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Background

- 4 Our Professional Indemnity Insurance (PII) arrangements (in combination with access to the Compensation Fund) ensure that there is a minimum level of financial redress available if a solicitor or an individual, working in a firm we regulate, is dishonest or incompetent. Access to these protections plays a key role in maintaining public confidence in using regulated law firms.
- 5 We have previously consulted on whether these protections remain appropriate, most recently in 2018, proposing a package of changes including lower indemnity limits and asking whether they would achieve the right balance between our regulatory objectives. The Board decided not to proceed with these changes, keen to avoid unintended consequences in a hardening market and where it could not be confident that the intended benefits would be realised. We said we would keep the efficacy and impacts of our insurance arrangements under review in this context.
- 6 We consulted from 14 April to 24 May 2021 on a clarification to our Professional Indemnity Insurance (PII) Minimum Terms and Conditions (MTCs), as set out in the note circulated to the Board in March 2021 attached as annex 1. This aimed to clarify the protection provided currently to consumers within the existing MTCs when they suffer a loss because of a cyber event at a law firm.
- 7 The MTCs do not prescribe the precise drafting of the insurance policies that firms must have in place, rather they set out minimum terms that must be met. Insurers can therefore draft their policies in any way that they wish, provided they maintain the cover required by the MTCs.
- 8 The existing MTCs require cover for losses to a client or other aggrieved third party caused by a cyber-attack that fall within scope of a claim for civil liability against a solicitor, supporting both the Legal Services Act Regulatory Objective to protect and promote the interests of consumers and the Objective to protect and promote the public interest. Losses to the law firm (first party losses), except for certain costs of investigating and defending a claim, are not covered.
- 9 Our consultation follows the Prudential Regulatory Authority (PRA) and Lloyd's of London (Lloyd's) recent requirement on insurers to put in place action plans to reduce unintended or unclear cyber exposures because the risk of cyber-attacks on individuals and businesses has increased.
- 10 PII policies fall into this category as they do not explicitly reference cover when a loss is caused by a cyber event. The requirement that Lloyd's has put in place is for its syndicates to insert explicit cyber clauses in their policies, with

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their original deadline being 1 January 2021, extended to 1 October 2021 for legal services PII.

- 11 We considered that consulting on inserting an additional clause into our MTCs provided the most robust way of delivering clarity to the market. This is the same approach adopted by other legal regulators, with whom we have engaged to ensure consistency of approach.
- 12 We were aware that the International Insurers Association (IUA) were developing a model clause for insurers that attempted to narrow the cover provided by our existing MTCs. This followed on-going lobbying by the insurance sector to reduce the protections in our MTCs more broadly, in light of external events impacting their profit levels. We were also aware that some law firms were unclear about the precise cyber cover provided by the existing MTCs when being sold additional cyber policies.
- 13 Our objectives set out in the consultation document were therefore to:
 - a. maintain the current position on level of protection for consumers intended by our MTCs in the event a cyber act resulting in loss
 - b. provide clarity for insurers and law firms as to the scope of cover for cyber risks that should be included in a PII policy
 - c. put law firms in a more informed position when reviewing the potential benefit of purchasing a separate cyber policy for other risks.
- 14 Given the technical nature of the proposal and complexities of our existing MTCs, we instructed expert insurance lawyers to draft a clause that best meets our regulatory objectives. We also engaged the relevant Law Society Committees, as well as insurers directly, taking their drafting suggestions into account. Following consultation, we are recommending some minor amendments to the clause on which we originally consulted.

Consultation responses

- 15 We received 31 responses to our consultation including from law firms, insurers and brokers and as above, we engaged directly with a range of interested parties. We will publish a post-consultation summary of responses in the usual way once we have your approval and will include this in our rule change application to the Legal Services Board (LSB) for the proposed clarifications.
- 16 As anticipated following our pre-consultation engagement, insurers argued that the clause should reduce the level of cyber cover that is currently within the MTCs. They said that the current MTCs give them limited scope to manage cyber exposure and this will impact on insurers' risk appetites and pricing. Some argued alternatively that any losses caused by a cyber event, should be

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subject to separate cyber insurance policies. One insurer said that whilst the clauses provide 'clarity' on what is covered they do not provide 'comfort'.

- 17 Conversely, the Law Society argued that the level of cover should be extended to cover first party losses.
- 18 We also received comprehensive drafting suggestions. While most law firms agreed that the drafting met our policy objectives of maintaining current protections, many insurers and brokers argued that it did not.
- 19 Given the technical nature of the consultation and some of the responses, we decided to hold a roundtable in July with our external lawyers attended by insurers, brokers and the Law Society. This was to make sure that we fully understood the aims of the drafting suggestions and spotted any potential unintended consequences of our proposed drafting.
- 20 The drafting feedback we received at the roundtable centred on two points:
 - a. that the clause could be clearer around when 'defence costs' would be covered, with a view that the draft consulted on could be interpreted as extending existing cover to include the business costs of managing the cyber incident
 - b. some preference, particularly from brokers, for more positive drafting language to say when cyber is covered rather than when it is not as set out in our draft clause.

Our proposed response

- 21 We remain clear that the objective of this exercise is to clarify the existing protections provided by our MTCs and not to review the policy of whether that level of cover is correct. This would be considered as part of any subsequent review of the policy aims of the MTCs more broadly. Such a review is something that the LSB has said that it will take forward with all legal regulators in the near future.
- 22 We have worked with our external insurance lawyers to review the drafting feedback that we received on consultation and at the roundtable. We are now proposing to add some further clarificatory language around defence costs coverage and make explicit that there is no intention to expand the scope of defence cover from that which is currently required by the MTCs.
- 23 We, and our external lawyers, remain of the view that our proposed drafting approach is appropriate and achieves our objectives. Because of the way that our MTCs are drafted, more positive drafting risks significant unintended consequences on other clauses, as well as a perception that the effect of the change is to provide additional cover.

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- 24 We have circulated the revised, post-consultation drafting to all the roundtable attendees for comment and to other insurers through our existing Insurance Liaison Committee, which we established to share information with insurers. We have received no new comments of significance.

Timeline

- 25 We had originally hoped to introduce the clarificatory clause ahead of insurers drafting their policies ready for the October PII renewal round. This is not possible given the need to consider carefully the technical and detailed feedback we received. Therefore, insurers will be writing policies for the October renewals based on the current MTCs. We have sent out the Participating Insurers Agreement for 2021/22 on this basis.
- 26 We do not think that this slight delay will impact on the renewal round. We have maintained communication with insurers around our proposals making it clear that although they can include endorsements to amend their policy wording covering cyber risks, there is currently and will be no change to the MTCs that would allow them to reduce existing levels of cover. We will monitor this position closely and are preparing communications, Q&A and other briefing accordingly.
- 27 We have engaged with Lloyd's of London and the PRA, who whilst urging that we proceed as quickly as possible, agreed that it was appropriate to take the time to properly understand the drafting proposals put to us and engage the industry on these. They are also content that our drafting approach meets their requirements.
- 28 Our aim now is to introduce the change as soon as possible and with maximum lead in time to the insurer reinsurance cycle, which happens at the beginning of each calendar year.

Next steps

- 29 If the Board agrees the draft clause, we will publish our response to the consultation and submit a rule change application to the LSB. We are keeping the LSB updated on progress and how we are managing the impacts of the revised timeline for making these changes. Its wider review of PII is likely to start in September and we are seconding some analyst resource to it for the project.

Recommendations: the Board is asked to:

- (a) agree our response to the consultation set out at paragraphs 21-24**
- (b) make the amendments to the MTCs set out in annex 2.**

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Supporting information

Links to the Corporate Strategy and/or Business Plan and impact on strategic and mid-tier risks

- 30 This aligns with Objective 1: set and maintain high professional standards for solicitors and law firms as the public would expect and make sure we provide an equally high level of operational service. It is clarifying our regulatory arrangements in light of external developments. It also aligns with our Objectives 3 objective around anticipating and responding to change.
- 31 Potential reputational risks are that the insurers continue to call for completely separate cyber cover policies and may be vocal in their disappointment that there is no reduction in the scope of cover in our MTCs, but our commitment to maintaining consumer protection and the fact that we have engaged directly with the PRA and Lloyd's should help counter any perceived criticism of SRA.

How the issues support the regulatory objectives and best regulatory practice

- 32 This clarification supports the Regulatory Objectives to protect and promote the interests of consumers and, as it supports public confidence, to protect and promote the public interest. It safeguards against risks that insurers may use any uncertainty to:
 - a. reduce consumer protection around cyber related losses without any analysis of what impact this would have on the consumer interest
 - b. require law firms to buy additional cyber cover including for liabilities that are already required under existing MTCs.
- 33 The clarificatory clause will help make sure that there is transparency for insurers, law firms and consumers about what losses out MTCs require insurers to cover through their PII policies.
- 34 Amending the relevant clause is proportionate, targeted and transparent, in line with best regulatory practice.

Public/Consumer impact

- 35 This is a clarification, not a policy change so should have no new direct public or consumer impact. It should help safeguard against the indirect risks highlighted in the section above.

What engagement approach has been used to inform the work and what further communication and engagement is needed

- 36 We have engaged extensively with the insurance sector and Law Society Committees through regular discussions while developing the proposed cyber clause for consultation and after the consultation including by holding a

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roundtable to review consultation feedback. This is as well as carrying out a formal consultation exercise.

37 We have also continuously communicated with the Prudential Regulation Authority and Lloyd's, who are driving the requirements for insurers to have policy wordings explicitly setting out cover for losses related to cyber events.

38 We will continue engagement and will also issue external communications clarification of the position for the October renewal round.

What equality and diversity considerations relate to this issue?

39 This is a clarification rather than a policy change and should not have any direct equality and diversity impacts. The amendment will apply to the PII MTCs for all firms, and therefore will protect and promote the interests of all clients, including the vulnerable

How the work will be evaluated

40 We will review the outcome of forthcoming renewal rounds to assess the impacts of the position adopted. This is as well as engaging regularly with the insurance sector and law firm representatives.

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Annexes

Annex 1 Note circulated to Board note circulated to the Board in March 2021
Annex 2 Clarification amendments for cyber exposures required in the SRA's Minimum Terms and Conditions for insurance

NB: annex 1 will not be published because it relates to emerging strategy or policy