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Insurance distribution activities, funding options, and adverse cost insurance

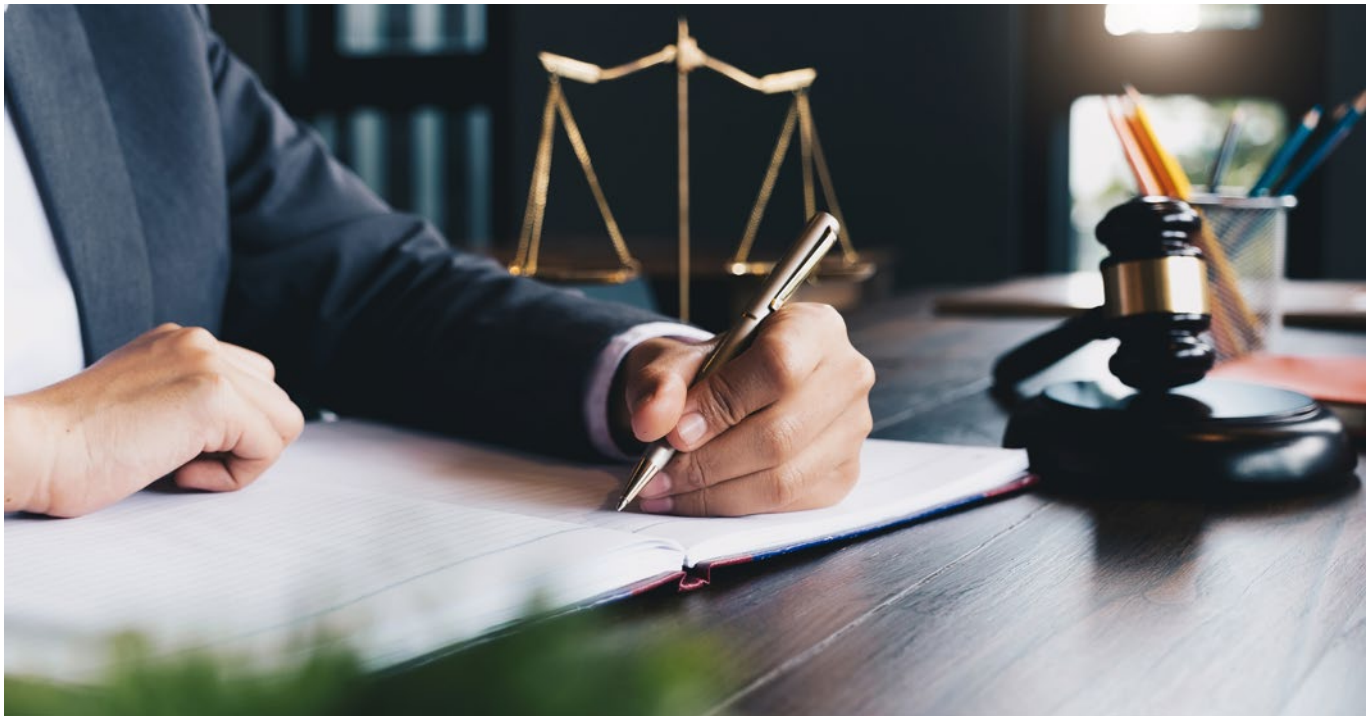
Regulatory developments and risk update.

Law firms involved in litigation, conveyancing, and probate will most likely be carrying on insurance distribution activities. For example, they may arrange after the event (ATE) insurance for a disputed claim, insurance for defective title in a conveyancing matter, or building insurance for a probate matter.

In addition, a number of Solicitors Regulation Authority (SRA) rules — which have been recently updated — also affect the requirements for solicitors and firms regarding insurance distribution activities.

These regulations, along with increases in funding options and adverse cost insurance in contentious matters over the last ten years, mean firms may find themselves inadvertently wandering into realms governed by significant regulation.

To avoid regulatory breach, it is imperative law firms and solicitors understand the current rules and how to meet them effectively.



What are the relevant rules and how have they changed?

The Insurance Distribution Directive (IDD) came into force on 1 October 2018, introducing significant requirements for all businesses involved in insurance distribution. At the time, we wrote a thorough article about the implications for law firms.[1]

The IDD defines "insurance distribution" as:

"...the activities of advising on, proposing, or carrying out other work preparatory to the conclusion of contracts of insurance, of concluding such contracts, or of assisting in the administration and performance of such contracts, in particular in the event of a claim."

In 2018, in furtherance of the IDD coming into force, the SRA introduced the Financial Services (Scope) Rules[2] (Scope Rules) and the Financial Services (Conduct of Business) Rules[3] (COB Rules). These were updated in November 2019 and December 2020 respectively. Further, the SRA Guidance for "Law firms carrying on insurance distribution activities" (SRA Guidance) was updated in November 2019. These impose the following requirements:

- The Scope Rules stipulate that you must not carry out any insurance distribution activities unless you are registered in the Financial Services Register and have appointed an insurance distribution officer (IDO) who will be responsible for your insurance distribution activities.[4] If you are carrying on, or proposing to carry on insurance distribution activities, you must notify the SRA in a prescribed form.[5]
- The COB Rules set out the scope of the regulated financial services activities that may be undertaken by firms authorised by the SRA (who are not regulated by the FCA). These rules regulate the way in which firms carry on such exempt regulated financial services activities. Part 3 of the Rules focusses on insurance distribution activities, with detailed requirements for firms and solicitors.
- The SRA Guidance confirms that the relevant persons within the management structure of the firm involved in insurance distribution activities, and all staff directly involved in insurance distribution activities, must hold appropriate knowledge and ability to perform their duties.[6]

It is quite clear that the above create significant requirements for law firms involved in insurance distribution activities. Firms need to establish clearly whether they are so involved. We recommend that all firms and solicitors familiarise themselves with the IDD, updated Scope Rules, COB Rules, and SRA Guidance.

We also consider the importance of understanding the requirements is paramount in circumstances where solicitors and firms undertake dispute resolution work. In our view, the additional regulatory obligations noted below could frequently result in a solicitor or firm involved in this area needing to undertake insurance distribution activities.

[1] Are you ready for more regulation? The Insurance Distribution Directive (marsh.com)
[2] https://www.sra.org.uk/solicitors/standards-regulations/financial-services-scope-rules/
[3] https://www.sra.org.uk/solicitors/standards-regulations/financial-services-conduct-business-rules/
[4] Financial Services (Scope) Rules (Scope Rules), Rule 5.2
[5] Financial Services (Scope) Rules (Scope Rules), Rule 5.3
[6] SRA | Guidance | Solicitors Regulation Authority
[7] https://www.sra.org.uk/solicitors/standards-regulations/principles/
[8] https://www.sra.org.uk/solicitors/standards-regulations/code-conduct-solicitors/
[9] https://www.sra.org.uk/solicitors/standards-regulations/code-conduct-firms/

The SRA Standards and Regulations (STaRs): funding options and adverse cost insurance. What are the obligations?

The introduction of the 2019 STaRs has strengthened the view that firms and solicitors have a regulatory obligation to advise clients of available funding and adverse cost insurance options.

The current relevant provisions are broadly drafted and include:

1. Principle 7 – acting in the best interests of each client.[7]
2. Code for Solicitors (Solicitors Code)[8] paragraphs 8.6. and 8.7:

- You give clients information in a way they can understand. You ensure they are in a position to make informed decisions about the services they need, how their matter will be handled, and the options available to them (8.6).
- You ensure that clients receive the best possible information about how their matter will be priced and, both at the time of engagement and when appropriate as their matter progresses, about the likely overall cost of the matter and any costs incurred (8.7).

3. Paragraph 7.1(c) of the Code of Conduct for Firms (Firms Code)[9] confirms that the aforementioned paragraphs of the Solicitors Code are also applicable standards for firms.

Therefore, in contentious cases in particular, explaining the funding and insurance protection options available to clients appears to be a regulatory obligation for firms and solicitors. Without such advice and/or discussion, the client may not be able to make an informed decision as to the services it requires or the options available to it. If a firm does not provide this advice, it could be difficult to see how the solicitor and/or firm have acted in the best interests of the client.

Furthermore, with contentious cases, there is always a possibility of losing at trial, and being ordered to pay costs. This would have a direct impact on the likely overall "cost of a matter". The need for solicitors and firms to provide advice on the mitigation of this risk by way of adverse cost insurance seems sensible, especially in conjunction with the Principle 7, outlined above.

Previous obligations and duties – has anything really changed?

Arguably, the obligation to explain the funding and insurance protection options available to clients is not new, and predates the IDD, Scope Rules, COB Rules, and the introduction of the 2019 STaRS.

The SRA's updated 2018 Handbook (Handbook) could be construed to mean that a failure to advise a client of the potential funding and adverse cost insurance options, in litigious circumstances, created a risk of breaching the SRA's 2011 Code of Conduct (2011 Code).

The SRA issued version 21 of its Handbook in 2018, including an updated version of its 2011 Code:

- Principle 4 of the mandatory "Principles" applied to both firms and individuals stating that they must "act in the best interests of each client" (similar to Principle 7 of STaRs mentioned at 1 above).
- Chapter One (of the 2011 Code) titled "You and your client" confirmed that it was a mandatory "Outcome" that clients were put in a position to make informed decisions about the services they needed, how their matter would be handled and the "options" available to them (similar to 8.6 of STaRs at 2 above).
- Indicative Behaviour 1.16 set out that "… discussing how the client will pay, including whether public funding may be available, whether the client has insurance that might cover the fees, and whether the fees may be paid by someone else such as a trade union…" may show how the mandatory "Outcomes" had been achieved (now appears to be subsumed into a combination of 1, 2, and 3 above).Therefore, a failure to advise a client of the potential funding and adverse cost insurance options, in litigious circumstances, arguably created a risk of breaching the 2011 Code (Principle 4 and Outcome 1.12). This suggestion is, in part, supported by the expectation of Indicative Behaviour 1.16.

On this basis, even before the 2019 changes, historically a solicitors and firms were under a regulatory duty to advise on funding options and insurance backed solutions.

Additionally, since 2010 solicitors and firms have been at risk from negligence claims if they failed to provide advice on such matters. In the case of Adris v Royal Bank of Scotland Plc,[10] HHJ Waksman QC stated that it was a "gross breach of duty" for the solicitor to not advise the client on the availability of ATE.

If a solicitor fails to provide such advice, the Court indicated that the solicitor is "effectively acting without instructions, since the clients were prevented from giving instructions on anything like an informed view of the case." This case was fact specific to the "costs-free" nature of the claims, but commentators cite it as demonstrating that a solicitor is under a duty to advise its clients on the availability of ATE.[11]

> **"Arguably, the obligation to explain the funding and insurance protection options available to clients is not new…even before the 2019 changes, historically solicitors and firms were under a regulatory duty to advise on funding options and insurance backed solutions."**

[10] www.bailii.org/ew/cases/EWHC/QB/2010/941.html
[11] https://www.stewartslaw.com/news/insurance-distribution-directive-new-insurance-rules-affecting-lawyers/; https://www.fenchurchlaw.co.uk/solicitors-liable-for-failing-to-advise-on-ate/

Conclusion

However old these obligations, it appears:

- In general, the IDD is likely to apply to many firms and creates a significant administrative and record keeping burden.
- In litigation, solicitors must provide advice to clients regarding:
  - Options for transferring costs risk in litigation.
  - The impact those options could have on the case outcomes.

Failure to advise could see a firm and/or solicitor fall foul of the regulations (and potentially even risk arguments of potential negligence). Against this background, firms and solicitors should be wary of what constitutes an insurance distribution activity and ensure they are familiar and acting in accordance with the IDD, Scope Rules, and COB Rules.

The combination of all these factors creates significant risk and effort for the profession in meeting the requirements, along with the necessity of keeping careful records to demonstrate adherence to them.

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