

BAR STANDARDS BOARD

REGULATING BARRISTERS

Enforcement Strategy

Introduction

1. The Bar Standards Board is committed to taking an outcomes focused, risk-based and proportionate approach to all its regulatory activities, which includes its approach to taking enforcement action.
2. This document sets out our strategy in relation to the enforcement of the regulatory requirements set out in our Handbook. In the context of this strategy, enforcement action means the application of sanctions to address non-compliance with the provisions of our Handbook. The strategy seeks to provide clear information and guidance about our approach to taking enforcement action as well as:
 - a) the outcomes we are trying to achieve through enforcement action;
 - b) to whom this strategy applies;
 - c) the role of enforcement in promoting regulatory compliance; and
 - d) how we will determine what action to take.
3. This strategy will be applied in conjunction with our Supervision Strategy and is underpinned by the detailed provisions of Part V of our Handbook (the Enforcement Regulations). Nothing in this strategy is intended to override the contents of the Handbook or limit any discretion which it confers.

Intended outcomes of this strategy

4. The main objective of this strategy is to achieve compliance with the regulatory arrangements set out in our Handbook by providing a framework in which to

take enforcement decisions. Enforcement action is intended to meet the objectives of:

- a) promoting adherence to the regulatory objectives as set out in section 1 of the Legal Services Act 2009 (the Act) and to our regulatory arrangements as set out in our Handbook;
 - b) providing a credible deterrence to non-compliance with our regulatory arrangements;
 - c) preventing further breaches; and
 - d) preventing those who represent a serious risk to the public from practising.
5. These objectives will be taken into account when determining what enforcement action to take in an individual case.

Scope of the strategy and our enforcement powers

6. We are entitled under the terms of the Act and our Handbook to take enforcement action against:
- a) individual barristers whether registered or not;
 - b) Registered European lawyers;
 - c) BSB authorised bodies (including barrister only entities (BoEs), legal disciplinary practices (LDPs) and alternative business structures (ABSs);
 - d) BSB regulated managers;
 - e) authorised (non-BSB) individuals working in BSB authorised bodies; and,
 - f) non-authorised individuals working for BSB authorised individuals or bodies.

The standards of professional conduct

7. The BSB's Code of Conduct, Part II of our Handbook, requires those we regulate to comply with the following core duties:
- You must observe your duty to the court in the administration of justice.
 - You must act in the best interests of each client.
 - You must act with honesty and integrity.

- You must maintain your independence.
 - You must not behave in a way which is likely to diminish the trust and confidence which the public places in you or the profession.
 - You must keep the affairs of each client confidential.
 - You must provide a competent standard of work and service to each client.
 - You must not discriminate unlawfully in relation to any person.
 - You must be open and co-operative with your regulators.
 - You must take reasonable steps to manage your business, or carry out your role within your business, competently and in such a way as to achieve compliance with your legal and regulatory obligations.
8. The core duties underpin the entire regulatory framework, define the core elements of professional conduct and set the mandatory standards that all BSB regulated persons are required to meet. The core duties are supported by a number of mandatory rules. In addition, the Code sets out the outcomes which compliance with the core duties and rules are intended to achieve. Enforcement action will be considered where BSB regulated persons fail to meet these requirements.

Promoting regulatory compliance through enforcement

9. The hallmarks of our enforcement strategy are as follows:
- a) **Risk-based** – We will focus our enforcement action on the issues that pose the greatest risk to the regulatory objectives. We will consider the nature of any alleged regulatory breach and consider the level of risk posed to determine what enforcement action we should take.
 - b) **Proportionality** – We will take proportionate enforcement action in the light of identified risks to ensure the stated outcomes of our Code of Conduct are met and compliance with the regulatory objectives is achieved.

- c) **Outcomes-based** – The outcomes identified in the Handbook, although not themselves enforceable, will be considered when deciding what action to take.
- d) **Individual responsibility** – Individual responsibility is at the heart of our regulatory regime. Typically, we will take action against an individual but action will be targeted at an entity alone or at an entity and individuals as appropriate.
- e) **Flexibility** – We will use a range of enforcement tools to promote compliance with our regulatory arrangements.
- f) **Fairness and openness** – When taking enforcement action, we will be as fair and open as practicable and will give regulated persons a reasonable opportunity to respond.

Sources of information that may result in enforcement action

10. The potential need to take enforcement action may be identified from a range of information sources including, but not limited to, the following:
 - a) complaints made to us from external sources such as clients, members of the public, lawyers or judges, law enforcement agencies or other regulators;
 - b) information that comes to our attention via other external sources, including the Legal Ombudsman;
 - c) information from the Supervision Department concerning breaches, particularly by chambers or entities.
 - d) information from other departments within the BSB.

11. We will only consider taking enforcement action in relation to information that discloses a potential breach of our regulatory arrangements. Some types of information are unlikely to result in consideration of enforcement action such as, for example:
 - a) information about a barrister's private life;
 - b) internal disputes within an entity or chambers.

12. Where information received is inconclusive, or relates to a matter such as those set out in paragraph 11, we would not normally conduct an investigation. However, in such cases we may retain the information for purposes of risk assessment and, in the case of chambers and entities, assess the risk posed by those bodies in order to determine the appropriate level of ongoing supervision required.

Options other than enforcement

13. On receipt of information as outlined at paragraph 10 above, the options listed below are available to us, as well as the enforcement tools described in paragraph 15:
- a) to refer the matter for supervisory action;
 - b) to refer a complaint submitted from an external source to another, more appropriate, body for consideration, for example referring an authorised (non-BSB) individual to their approved regulator;
 - c) to dismiss a complaint, with or without advice, because it does not reveal a potential breach of the Code or there is no realistic prospect of securing a finding of professional misconduct and it is not in the public interest to pursue disciplinary proceedings; or
 - d) to decide that No Further Action should be taken in line with the relevant provisions of the Complaints Regulations.
14. As stated in paragraph 13, we may decide to refer a case to our Supervision Department to address non-compliance through supervision tools as opposed to enforcement tools. When deciding whether this approach would be appropriate, we will consider:
- a) the seriousness and nature of the non-compliance identified;
 - b) whether the matter can be addressed through supervision without the application of sanctions; and,
 - c) whether applying supervision tools will be a proportionate response to the non-compliance identified.

Enforcement tools

15. The enforcement tools available to us include:
 - a) imposing an administrative sanction;
 - b) referring a case to the Determination by Consent Procedure; and,
 - c) referring a case to a Disciplinary Tribunal.

16. In addition, we have some additional powers that can be used in relation to BSB regulated entities.

Circumstances in which enforcement action will be taken

17. We will only take enforcement action where we have investigated a matter, or have received information from another regulator or ombudsman whose own investigation of the matter indicates that a breach of our regulatory requirements may have occurred, or where a finding has been made pursuant to another regulator's enforcement processes which has established on a balance of probability (or to a higher standard) that such a breach has in fact occurred.

18. In determining which of the enforcement tools, if any, to apply, we will consider a range of factors including but not limited to:
 - a) the risk posed to, or the impact on, one or more of the regulatory objectives;
 - b) whether any of the outcomes in our Code of Conduct have been adversely affected;
 - c) the seriousness of any potential breach;
 - d) whether the breach is an isolated incident or part of a pattern of repeated breaches;
 - e) whether the breach, if proved, would amount to a criminal offence;
 - f) the impact of the act or omission taking into account our regulatory priorities as stated from time to time;
 - g) the impact on clients or others if we take action compared with the impact of not taking action;

- h) the impact on public confidence in the profession and the administration of justice;
- i) the period of time over which the act or omission took place;
- j) the number of individuals affected and the seriousness of the adverse impact (or potential adverse impact) on those individuals (particularly if vulnerable clients are affected);
- k) evidence or a record of insufficient care being taken over compliance or of recklessness, deliberate breaches, or dishonest behaviour;
- l) whether the regulated person self-reported and has taken, or intends to take, steps to correct the breach and to provide appropriate redress; and/or,
- m) whether the resources required are disproportionate to the likely sanction.

Applying our enforcement tools

19. In relation to the enforcement tools set out in paragraph 15, we will consider by reference to the factors at paragraph 18 whether a matter should be:
- a) treated as a breach of the Handbook not amounting to professional misconduct and referred for consideration of the imposition of administrative sanctions (the Complaints Regulation at Part V of our Handbook identify the administrative sanctions that can be imposed including warnings and fines), in which case the standard of proof applied will be the balance of probabilities; or,
 - b) referred to disciplinary action as potential professional misconduct, whether via Determination by Consent or Disciplinary Tribunal, where:
 - i. the imposition of an administrative sanction would not be appropriate or proportionate, and,
 - ii. there is a realistic prospect of securing a finding on the criminal standard of proof and pursuing disciplinary action is in the public interest (the Complaints Regulations at Part V of our Handbook set out the range of sanctions available, including disbarment, suspension, disqualification or the imposition of a significant fine.)
20. We may impose an interim suspension, disqualification or condition on a BSB regulated person to prevent them from practising until their case is considered by a Disciplinary Tribunal. In very urgent and serious cases an interim

suspension or disqualification may be imposed immediately where we are satisfied this is necessary to protect the public. The regulations relating to Interim Panels, including the available sanctions, are in the Interim Suspension and Disqualification Regulations at Part V of our Handbook.

21. In relation to BSB regulated entities, we have the following additional powers that we can use where the statutory conditions in the Legal Services Act 2007 for the exercise of such powers are met.
 - a) We can intervene in an ABS (this does not apply to individual barristers, chambers, barrister only entities or LDPs) to take control of clients' files and/or money. We might use this power, for example, to protect clients' interests where we have removed an ABS's licence.
 - b) We can also apply to a court to have an ownership interest of a non-authorised person divested, that is disposed of or sold, and to place restrictions on their shares in an entity. We may use such powers, for example, where an individual has obtained an interest in an entity without our approval.
22. Further details about these arrangements can be found in the Interventions and Divestiture section at Part V of our Handbook.
23. In all instances where enforcement action has been taken, the Supervision Department will consider whether follow-up supervision would be effective in reducing the likelihood of future issues of non-compliance.

Decision-makers

24. Decisions to take enforcement action under this strategy can be taken by any of the following depending on the nature of the case and the relevant decision making authorities given under Part V of the Handbook:
 - a) our Professional Conduct Committee or authorised groups or individuals of that Committee;
 - b) staff within our Professional Conduct Department as authorised by the Professional Conduct Committee and/or its Chair; and,

- c) members of Disciplinary Tribunals.
25. All those involved in taking decisions under this strategy and the relevant provisions of the Handbook will be trained and given guidance so that decisions are made consistently and appropriate sanctions applied. Decisions will be monitored to promote consistency.

Openness and transparency

26. **Right of appeal or review** – Where we have decided to take enforcement action the regulated person concerned will always have an opportunity to appeal the decision or have it reviewed. The precise nature of the appeal will depend on the type of enforcement action taken.
27. **Publication of outcomes** – We will publish general statistics about the types of complaint received and all outcomes so that the levels of compliance by BSB regulated persons can be understood. We will also:
- a) publish findings as a result of disciplinary action on our website, and/or the website of the independent body that administers Disciplinary Tribunals, including decisions on disqualifications;
 - b) ensure that members of the public who search our on-line register will be able to access any published disciplinary findings/disqualifications against a BSB regulated individual;
 - c) provide details of any disqualification to the LSB and all other Approved Regulators;
 - d) Formally record administrative sanctions but not make them public otherwise than in accordance with Regulations 90 and 91 of the Complaints Rules;
 - e) publish the details of any conditions imposed on an authorisation or licence.

Strategy Consultation, Review & Evaluation

28. This strategy came into effect 6 January 2014. We shall consult with stakeholders to evaluate its effectiveness two years from its initial application

and amend where appropriate. In the meantime, we welcome any feedback on the strategy's content, implementation and effectiveness.

29. All the regulations and procedures referred to in this strategy are available on our website at <https://www.barstandardsboard.org.uk>.

Equality considerations

30. We are committed to ensuring the application of this strategy is fair and equitable and does not disadvantage anyone because of their age, disability, gender reassignment, marital and civil partnership status, pregnancy and maternity, race, religion or belief, sex or sexual orientation. BSB regulated persons subject to this strategy should advise us of any reasonable adjustment or specific requirements they have. These will be accommodated as far as is reasonably practicable and in line with our obligations under the Equalities Act 2010.
31. We will monitor any enforcement action under this strategy to ensure there is no disproportionate impact on any equalities groups within the community we regulate.

January 2014

Note on compensation arrangements

Introduction

1. The BSB has explained in its draft licensing authority application that it has reached the view that “appropriate compensation arrangements”, in order for it to regulate ABSs, should not include establishing a compensation fund. This note sets out the BSB’s rationale in coming to this decision.

The nature of the risk that are we seeking to cover

2. In considering whether a compensation fund is necessary the BSB has first had to give thought to the risks we would be seeking to cover. Attached at **annex A** is a table that sets out the risks in more detail, any existing mitigation in place, the evidence we have about the likelihood of the risk occurring, and whether there is any residual risk to be considered.
3. The primary reason¹ other regulators have compensation funds in place is to address the risks associated with handling client money, which their regimes expressly permit and seek to regulate. In contrast, the BSB places an express prohibition on individuals or entities handling client money through a clear rule in its Handbook. This preserves and extends to entities the long-standing prohibition on individual barristers handling client money. Past experience of that ban as it has operated in respect of individual barristers supports the view that breaches are likely to be rare.² That is all the more the case in circumstances where (a) the BSB has now established a supervision regime, which will include monitoring compliance with the ban (as outlined below); and (b) alternatives have meantime been developed in the marketplace which eliminate the need for a legal service supplier to hold client money (such as BARCO, which is regulated by the FCA and carries its own insurance arrangements).
4. One must also bear in mind that those regulated by the BSB are providing advocacy and litigation services and specialist advisory/legal drafting services rather than, for example, providing conveyancing services or other transactional services. This will be confirmed as part of the licensing process and in the context of ongoing supervision (see below). Therefore, the services in question will not involve routinely holding a (potentially substantial) purchase price on behalf of a client, in the way that

¹ Whilst in some cases compensation funds can in principle be called on to meet other types of claims, these other claims will usually be covered by insurance and claimants on the fund will be expected to resort to the fund only as a last resort. In practice, therefore, the primary role of compensation funds is to meet claims for misappropriation of client money in those cases where insurance cover will not respond because of dishonesty on the part of the insured.

² There have only been two instances where disciplinary findings have been made against barristers in relation to handling client money. The first finding was in 2009 and details can be found at the following link: <https://www.barstandardsboard.org.uk/complaints-and-professional-conduct/disciplinary-tribunals-and-findings/disciplinary-findings/?DisciplineID=75003>. In this case the barrister took some £2500 in cash from a client for services which he did not fully render. Eventually £1500 was returned. The second finding was in 2010, details of which can be found at the following link: <https://www.barstandardsboard.org.uk/complaints-and-professional-conduct/disciplinary-tribunals-and-findings/disciplinary-findings/?DisciplineID=74848>. The barrister was found to have taken £250 on account improperly and a disbursement of £155 which was not transmitted to the Home Office. We have no information that suggests the sums were returned.

is characteristic of the services of solicitors or conveyancers regulated by the SRA and the CLC. Rather, to the extent clients do pay any money over to any individual or entity regulated by the BSB, one would expect that money in general to relate only to fees or disbursements. Such payments will only amount to client money if, in breach of the ban, payment is taken on account (i.e. before the fees have been earned or a disbursement incurred on behalf of a client), rather than in arrears or by way of an agreed fixed sum. As to settlement monies changing hands in the context of prospective or actual litigation, these could only end up in the hands of someone regulated or licensed by the BSB if, both, the payer was ignorant of the ban (which will certainly not be the case if the payer has legal representation) and the recipient dishonestly took the payment nonetheless.

5. Given all of those factors, a situation where an ABS licensed by the BSB does hold client money, in breach of the ban, would by definition be exceptional. Such an exceptional situation will only result, in turn, in loss to consumers if, in addition, (a) the client money is misapplied (whether deliberately or through carelessness) and (b) the client is unable to recover the funds from the ABS or from any other individual who may be civilly liable for the loss (for example, on the principles relating to constructive trust). In general, the Courts would provide an avenue for redress in the event of misapplication or misappropriation of client funds, unless the ABS (and anyone else liable) is insolvent and not good for the amount of any judgment that may be awarded against it. In that scenario, the professional indemnity insurance of the ABS is unlikely to fill the gap left by the ABS being unable to satisfy its liability. The BSB's proposed minimum terms would not require cover to be offered for client money, in the light of initial feedback from insurers on the likely costs implications. This proposition is being more rigorously examined through market testing, the results of which are expected in late February. That worst case scenario is thus the residual risk we are concerned with. The BSB has therefore had to consider whether it would be proportionate to establish compensation arrangements to cover this residual risk in establishing a regime for ABSs.
6. The same residual risk, in principle, exists in respect of individual barristers and non-ABS entities. It is not unique to ABSs. The BSB's existing arrangements for individual barristers and non-ABS entities do not include a compensation fund to guard against the residual risk that they will breach the prohibition in a manner that causes a consumer loss. Such arrangements were, rightly, not considered necessary when the LSB recently considered and approved the BSB's application to change its rules so as to authorise non-ABS entities. Whilst it is appreciated that the statutory test for designation as a licensing authority differs, nonetheless, the BSB takes the view that a difference in treatment as between ABSs and other business models, in this respect, could not on any view be justified. The answer must in principle be the same for individual barristers, non-ABS and ABS entities regulated by the BSB. For the reasons summarised in this note, the BSB has concluded that in none of these cases should its regulatory arrangements include a compensation fund.

Evidence as to the scale of the risk and alternatives for addressing it

7. Historically, the BSB has limited evidence, from its Professional Conduct Department³ to suggest there have been significant issues in relation to the loss or misappropriation of client money by barristers⁴. This limited evidence in itself strongly suggests that it would not be proportionate to establish compensation arrangements to cover the residual risk of someone breaching the client money rule.
8. There has however, recently been one specific instance (that the LSB will be aware of) where the Supervision Department has discovered a chambers whose members were conducting activity that might possibly amount to the holding of client money. In that instance, the issue related to receipt of fees in advance, in circumstances where that might amount to client money, rather than an explicit operation of a client account. This had been identified through proactive supervision. Steps have been taken to address this in order to protect clients and this has also informed forthcoming changes to guidance in the BSB Handbook on holding client money and the taking of fees in advance⁵.
9. In the circumstances described above, supervision was effective in detecting the issues so that appropriate mitigations could be put in place. However if a circumstance were to arise where barristers are not willing to remedy the position voluntarily as soon as it is identified, the BSB could use its powers (for example, of suspension, or imposing conditions) to put pressure on them to do so or to prevent them from undertaking work in areas where clients are potentially at a greater risk such as through public access instructions. Clients could also seek and enforce judgment against them for the debts (and there is no suggestion that this would have gone unsatisfied). Or, as an alternative to going to court, the client could seek compensation from the Legal Ombudsman (which would also save the client court fees). Thus, there are existing avenues for ensuring that a BSB regulated individual or entity who wrongly holds client money hands that money back to the client, as long as they are solvent. The risk of insolvency of a supplier of legal services, per se, is not a risk clients can reasonably expect a legal services regulator to eliminate, although supervision may help to mitigate it somewhat.
10. It should be noted that the BSB does not propose that its minimum terms of insurance should mandatorily include insurance for any breach of the prohibition on client money. That is due to concerns that requiring such cover as a minimum will unnecessarily increase the costs for all, in order to cover this residual risk (costs which will in due course be passed on to clients). The insurance market testing referred to above will enable us to validate this concern. The same issue of proportionality arises in this respect. Certainly, in the SRA regime, exposures in respect of client money contribute significantly to insurance costs. The BSB's policy

³ Between 2008 and 2015 to date, the BSB has received 11 complaints in total in relation to "receipt of gifts/inappropriate payments/handling client money." Of those 11, 5 have been dismissed, 2 have been withdrawn, 3 are ongoing and 1 was proved, but the charge proved wasn't in relation to the handling client money component.

⁴ See footnote 2 above for two disciplinary findings in relation to handling client money

⁵ gC107 of the BSB Handbook has been revised with effect from April 2015.

objective in creating a regime where client money would remain banned, was in part to remove the associated costs from the equation, so that those it regulates would be able to pass on the resultant savings in lower fees, thereby promoting competition for their services and/or reduce potential barriers to entering/continuing in the market. Those policy objectives are undermined if those the BSB regulates nonetheless have to insure to cover client money, which they are not permitted to handle. That said, any insurer is free to offer insurance which exceeds the minimum, so if insurers were willing to propose such cover at a cost entities could afford then the minimum terms would not prevent them from taking this option up. An entity could therefore choose to cover itself against the risk of a “rogue” partner or member of staff abusing the ban on client money, but it would not be obliged to do so – absent insurance, the entity itself would carry that financial risk (being vicariously liable for their actions in the course of providing its services).

11. The BSB has also considered situations, not involving client money, where a client might suffer loss because of the dishonesty of a BSB regulated person or entity. The risk to consumers of dishonesty on the part of the individual providing services to them can be mitigated, in the case of an entity, by ensuring that insurers agree to cover losses if any of the managers or partners in an entity (as policy holders) are not guilty of dishonesty, and in fact this is something that will be specifically included in the BSB’s minimum terms. Insurers will not pay out, however, in circumstances where all of the managers and policy holder have acted dishonestly. The BSB accepts that as a result there may be limited circumstances where the insurance refuses to cover the loss to the client arising from dishonesty. Again, this is the existing position as regards individual barristers, who are likewise not insured in respect of their own dishonesty. However, the BMIF reported in its recent consultation response that it has never had to exercise any of its rights under clause 4 (or its predecessor provisions) of its minimum terms (this clause entitles BMIF to refuse to indemnify an insured for misrepresentation and non-disclosure) as to date the relevant circumstances have never arisen. In these circumstances, whilst again there is a residual risk in this respect, there is no evidence that this is resulting, or would in future result, in significant client detriment. In fact, in the case of an entity it is more rather than less likely that existing insurance terms would ensure the client is compensated (because in most cases there will be at least one honest insured, even if others within the entity have acted dishonestly).
12. The annex identifies certain other circumstances in which clients might possibly be left with losses not covered by insurance. As will be seen, the analysis concludes that there are mitigating arrangements in place and that the residual risks are low. In every case, clients would only suffer losses if the event giving rise to the risk occurred and the entity was insolvent.

Supervision and monitoring

13. The Supervision Programme currently includes the following key aspects from the Handbook in relation to handling client money:

5. Financial management

5.3 Handling client money

Handbook Core Duties

- CD3: You must act with honesty & integrity
- CD5: You must not behave in a way which is likely to diminish the trust & confidence which the public places in you or in the profession
- CD10: You must take reasonable steps to manage your practice, or carry out your role within your practice, competently and in such a way as to achieve compliance with your legal and regulatory obligations.

Handbook section C5

Outcomes:

- oC24: Your practice is run competently in a way that achieves compliance with the Core Duties and your other obligations under this Handbook. Your employees, pupils and trainees understand, and do, what is required of them in order that you meet your obligations under this Handbook.

Key processes: rules rC73-75

- Barristers & Chambers are prohibited from holding client money.
- Client money held and processed via an FCA-authorized third party payment service.
- Due diligence performed on third party payment systems.

14. This is monitored through the Supervision Return and through risk-based visits to Chambers. In relation to payment arrangements, the last supervision return specifically asked about the information chambers provides to clients about the fees they charge and the terms and conditions associated with those fees. For client money, respondents were asked to include information including the circumstances in which any client money is held, specifically whether money is held via a third party escrow account. At visits, payment arrangements, client care letters and complaints reports are assessed and enable identification of potential issues concerning payment of fees or holding of client money. In addition, a visit involves inspection of bank accounts, which helps to identify concerning practices or payments.

15. The Supervision department will continue to collect and gather evidence in this area through the Supervision Return process and other supervision visits in order to develop the Supervision Team's approach to supervising risks associated with client money in the future

Is it proportionate to establish a compensation fund?

16. Regulatory regimes do not seek to eliminate every risk, regardless of the costs of doing so. The BSB could not find any precedent for imposing a compensation fund in order to address the residual risk of loss of client money in circumstances where there is a clear and absolute ban on holding client money at all.⁶ To do so would inevitably impose an additional financial burden on each member of the regulated community, a cost which would ultimately be likely to be passed on to consumers and/or act as a barrier to entry. There is no evidence that the existing position (whereby client money is banned but there is no compensation scheme) has resulted in significant consumer detriment or that it would be likely to do so in future.⁷ Redress through the courts would result in recompense unless the party responsible for misapplying the funds was insolvent. The supervision regime will serve to mitigate the risks that, as new business structures develop, the ban on client money will be misunderstood or circumvented. It will also seek to identify entities at risk of financial collapse. It will do so at the point of authorisation through the assessment of information provided by applicants. Entities will be required to provide, amongst other documents their business plan, a three year financial plan and a disaster recovery business continuity plan. There are currently appropriate financial and accounting staff skills within the Supervision team to assess these documents, and to query where there are marked differences in year on year financial projections. Staff will also ensure that information contained in the business plan matches what is contained in the financial projections (for example, the figures for wages of employees should match up to the number of employees described in the business plan). The approach taken to assessing markers for potential insolvency, will of course be informed by the BSB's supervision strategy: the nature and level of engagement with entities in relation to their financial stability will depend on the BSB's risk assessment. Medium to high risk entities, for example, will be required to submit annual accounts for BSB scrutiny and supervisory activity will follow as required.
17. All these factors (as well as the others discussed in the paper) assisted to inform the BSB's conclusion that no compensation fund was necessary, whether for those it currently regulates, or for ABSs. In reaching that view, the BSB considered two options for ways in which compensation arrangements could be put in place:
- i. Compensation arrangements based on a policy of insurance.
 - ii. A compensation fund paid for through a levy on the profession.

Option 1

18. The BSB has considered using an insurance policy to fund any compensation awards. The BSB has noted that this was the course adopted by CILEX albeit in their case as an interim measure. Initial informal soundings indicated that this was likely to be a significant cost, assuming insurers willing to write such a policy could be found. Insurers may well find it difficult to arrive at a sensible rating of the risk that the regulatory ban on holding client money will be breached and may therefore tend to charge an excessive premium (since the available experience is of losses of client money in other regimes which expressly permit the holding of client money and there

⁶ See "other regulators" below.

⁷ See above.

is no direct parallel). The BSB has put in hand further research into the likely cost of funding an insurance premium and is expecting to receive a report on this by the end of February. As part of our research we will also include reactions to market testing on minimum terms that do and do not include cover for handling client money, to help us assess the impact this would have on the cost of a central policy to cover compensation arrangements, but also on individual policies. However, rather than delay its application (which the BSB considers to be in the public interest and should be progressed), the BSB decided it should proceed with the further research whilst the application is under consideration by the LSB.

19. The question of principle is whether it is necessary and appropriate for the BSB to incur what would on any view be a significant cost in putting in place insurance for this residual risk (passing that cost on by way of the fees charged to its regulated community) or whether that is disproportionate given the residual nature of the risk.
20. The BSB could fund an insurance premium from its general budget, whereas a levy on the profession to raise a compensation fund (see option 2 below) would probably require an express power in statute. Therefore, in the event that the LSB were to disagree with the BSB's current assessment (i.e. that no compensation fund is necessary as part of its compensation arrangements) option 1 is then the only option that could, in principle, be put in place without further delay, given that the BSB (unlike the SRA) currently has no statutory power to raise a compensation fund.
21. The BSB is in the process of liaising with Marsh, an international insurance broker to establish what the cost would be of setting up compensation arrangements based on a policy of insurance. We expect Marsh to report to us by the end of February. The BSB will provide the LSB with further information on this in due course.

Option 2

22. For the reasons summarised above, the BSB took the view that if it were to operate a compensation fund it would not be appropriate to restrict it simply to licensed bodies, thereby providing consumers of legal services from a BSB licensed body with greater protection than would apply to consumers receiving legal services from other BSB authorised persons and bodies. Any such fund would have to be equally available to consumers of services from any BSB regulated individual or entity.
23. If the BSB were to establish a compensation fund comparable to the SRA's (for example), as we have a smaller regulated community, it is likely that the regulated community would have to provide large contributions to the fund in order for it to operate. This would likely place an undue burden on the profession and may also serve as a barrier to entry into the profession.
24. Although we would also expect claims to the fund to be very few, the fund would have to be large enough to cover all the claims which might be made in one period. With an expected smaller coverage than the SRA's scheme, for example, claims could vary considerably from year to year, so there would have to be enough money in the fund to cover a particularly bad year where more or larger claims were made than expected.

Other regulators

The SRA's compensation fund

25. The BSB has considered what is to be learned from experience of claims made under the SRA's compensation arrangements.
26. A report by the Legal Services Consumer Panel, *Financial protection arrangements* (June 2013), prepared for the LSB, states:

"Thematically, client accounts are considered a high risk, while residential and commercial property conveyancing, and wills, estate administration and probate are thought to be the highest risk areas of law."

27. Research carried out for the SRA's compensation fund review by Economic Insight in 2014 supports this contention, showing that a high proportion of claims paid out by the compensation fund related to conveyancing and probate. The claims by reason against the SRA compensation fund in 2014 were as follows: return of payment on account of costs (27%), probate – balance due to the estate (20%); and failure to pay SDLT or land registry fees (19%); other (14%); (remaining 20% no information available). Further, the highest value of paid claims by far related to theft of client money amounting to around £200,000. This was four times as much as the reasons for next highest claims which were probate and conveyancing (each category amounting to around £50,000). The remaining reasons for claims amounted to significantly less than £50,000. Whilst barristers sometimes advise, or provide drafting services, that are related to conveyancing or probate, they rarely, if ever, actually carry out the transactions, or administer estates. On the basis of the BSB's Entity Regulation Policy Statement, these are activities that BSB authorised bodies are highly unlikely to carry out.

Other regimes

28. As well as considering the SRA's compensation fund, the BSB has also carried out some research into other regulators. As has already been explained, the BSB has been unable to find an example of a regulator that similarly bans the handling of client money and yet has a compensation fund to cover the risk that the ban will not be observed. However, there is an interesting example of a regulator who allows their regulated community to hold client money but does not have a compensation fund in place. The Architect's Registration Board (ARB) specifically allows architects to hold client money in their Code of Conduct but considers that the insurance arrangements that architects are required to have in place are sufficient to cover any losses that consumers might face (even though such insurance would be unlikely to respond in the event of dishonest misappropriation of client money by a sole practitioner). This might be thought to be a rather more significant risk, in the context of a regime where client money is permitted, than the residual risk that the BSB is addressing, in a regime where it is banned.

Conclusion

29. At the present time the BSB does not consider that it would be appropriate to put in place a compensation fund (or insurance arrangements designed to perform an equivalent function), simply to cover the residual risk that the prohibition on the handling of client money could be breached, or one of the other risks materialises, and a client suffers loss as a result.
30. On current information, that step is not justified at the present time (and whether it ever becomes justified in future would need to be assessed on the basis of the evidence then). It is essential not to lose sight of the point that gold-plating in order to eliminate such residual risks altogether always involves an incremental cost (direct and indirect), which is then likely to be passed on to consumers or act as a barrier to entry. That approach would run counter to the BSB's endeavours to encourage the development of new innovative types of business structures for delivery of the types of services that consumers have traditionally sought from the Bar, which nevertheless preserve the lower overheads historically typical of the Bar (in comparison with the overheads typical of traditional solicitors firms) and which would therefore be well placed to address the gaps that currently exist in the provision of affordable legal advice and representation.
31. However, the BSB recognises that our assessment of risks might change, particularly as we gain more experience of regulating entities and gather more evidence through monitoring and supervision against the backdrop of a developing market. In order to cover the eventuality that the BSB may need to establish compensation arrangements in future, we will be including a provision in the section 69 order to allow us to do so. This is not because the BSB resiles from its current view on the need for a compensation fund. Rather, it is designed to preserve the BSB's ability to react appropriately in future, in the event that its monitoring of the impact of changes in the market shows that the relevant risks have changed and therefore that a change in that conclusion is warranted.

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Annex A

This table starts by analysing the risks which might result in clients who have a justified claim against an ABS suffering losses. Most such claims will be met either by the ABS's insurer or by the ABS itself, but in certain limited circumstances the insurer may refuse to pay and the ABS may not have the resources to meet the claim. The table outlines the mitigation which will be in place to reduce the likelihood of claims not being met and assesses the residual risk. In deciding whether it would be proportionate to require compensation arrangements, it is only this *residual* risk which should be considered.

Risk	Mitigation	Evidence about risk	Residual risk
Client money held, misused and ABS cannot refund	<p>Ban on holding client money.</p> <p>Requirement to confirm that client money not held.</p> <p>Requirement to report serious misconduct</p> <p>Permitted services will not include those which normally involve handling client money</p> <p>Supervision checks on fee handling.</p> <p>Supervision consideration of solvency.</p> <p>Insurance unless all insured persons (managers as well as the ABS) have been complicit in the misuse of client money (subject to minimum terms provisions).</p> <p>Powers to suspend licence or impose</p>	<p>SRA evidence shows that holding client money, conveyancing and probate are the services for which claims for compensation most often have to be met. BSB regulated ABSs will not be able to hold client money or normally to undertake such services.</p> <p>Risk greatest in small ABSs which are most similar to self-employed barristers. There are only two examples where there has been a breach of the client money</p>	<p><u>Large amounts</u> (dishonesty probably involved):</p> <p>Likelihood: very low</p> <p>Impact: high</p> <p>Overall assessment: low</p> <p><u>Small amounts</u> (probably administrative error):</p> <p>Likelihood: low</p> <p>Impact: low</p> <p>Overall assessment: low</p>

	<p>conditions</p> <p>Intervention powers</p>	<p>rule and clients have suffered loss as a result (see footnote 2 above)</p>	
<p>Dishonest actions not covered by insurance and ABS unable to pay</p>	<p>Insurance minimum terms will require cover to be provided unless all insured persons have been involved in or condoned the dishonesty</p> <p>Requirement to report serious misconduct</p> <p>Supervision review of complaints and any other suggestion of dishonesty</p> <p>Supervision consideration of solvency</p> <p>Powers to impose conditions or suspend licence</p> <p>Intervention powers</p>	<p>No evidence of clients losing money as a result of insurance not covering dishonesty by insured</p>	<p>Likelihood: low</p> <p>Impact: low-medium</p> <p>Overall: low</p>
<p>No insurance or does not comply with minimum terms or has expired</p>	<p>Initial authorisation dependent on having insurance complying with minimum terms</p> <p>Annual confirmation required</p> <p>Requirement to notify BSB within 7 days if any mandatory condition, including insurance, is not met</p> <p>Minimum terms require insurance cover to be extended for a period to allow</p>	<p>[No evidence as BMIF is committed to covering all self-employed barristers]</p>	<p>Likelihood: low</p> <p>Impact: medium</p> <p>Overall: low</p>

	<p>for orderly rundown if new cover cannot be obtained</p> <p>Supervision action to impose conditions or close down if insurance not obtained</p>		
<p>Money legitimately accepted (eg fixed fee paid in advance) but service not delivered and money not returned due to insolvency</p>	<p>Supervision consideration of solvency</p> <p>Obligation on authorised individuals if an ABS ceases to practise to assist in an orderly wind-down</p>	<p>No evidence of any client losses when Chambers have closed</p> <p>Very unusual to have a compensation fund to cover losses due to cessation of business</p>	<p>Likelihood: low</p> <p>Impact: low</p> <p>Overall: low</p>