



Solicitors  
Regulation  
Authority

**Application made by the Solicitors Regulation Authority  
Board to the Legal Services Board under Part 3 of  
Schedule 4 of the Legal Services Act for the approval of  
changes to regulatory arrangements relating to  
Compensation Fund contributions  
17 July 2015**

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**Application made by the Solicitors Regulation Authority Board to the Legal Services Board under Part 3 of Schedule 4 of the Legal Services Act for the approval of changes to regulatory arrangements relating to Compensation Fund contributions.**

**A. Proposed Alterations**

***Compensation Fund Contributions***

1. The SRA needs to set the Compensation Fund contributions for the practising year 2015/16. The methodology used to allocate the cost of the Fund throughout the regulated community remains the same as last year. 50% of the funding requirement will be met by a fixed contribution from regulated individuals, and 50% by a fixed contribution from regulated firms. A contribution level of £8.5m would result in an individual contribution of £32 and a firm contribution of £548 which is the same as last year.
2. The proposed level of contribution has been calculated in line with the methodology used in previous years, which involves assessing expected payouts and levels of claims by looking at historic trends in relation to claim numbers, amounts and timings and refined to take account of relevant more specific information where available. As was the case last year, the value of open claims on the Fund has reduced significantly, mainly due to revised processes and improved efficiency leading to more straightforward claims being processed quicker than in previous years.
3. The calculation uses the best view of predicted numbers and costs of interventions for 2015/16 onwards, continuing trends for business as usual, the impact of the closure of the ARP and claims in relation to uninsured firms with consideration also being given to any high risk potential liabilities where known. Intervention costs of £6.8m are included and this is based on a predicted level of 45 interventions. The total cost in the 2016 NFR is broken down into £363k staff costs, £2.2m legal fees (external agents costs) and £4.3m archiving costs. This compares with a total budget of £9.6m for 2015 (£355k staff costs, £4.09m legal fees and £5.2m archiving costs). We do expect the archiving costs to reduce further from next year now we have started destroying files following the successful application to Court. An update on this is provided at Annex D.
4. The forecast sum for grants during 2015/16 of £12.8 m (as shown in Annex A) can be split so the sum relating to uninsured firms is £2.0m and the sum for all other claims is £10.8m in 2015/16 and £13.0m and £14.6m in subsequent years. The sum of £2.0m has been included for claims in relation to uninsured firms, which is based on the estimated potential pay out in relation to the current open claims.
5. The first proposal of the Compensation Arrangements Review (CAR) , the introduction of eligibility criteria for applicants to the Fund has been implemented in 2014. This will protect the Fund against lender and other corporate claims although in a relatively benign conveyancing market there are few such claims and so the financial impact at present is low. The categories of claimant who will now be ineligible were rarely successful in their applications as they were usually unable to show hardship. However should there be, for instance, another sharp rise in claims from lenders due to mortgage fraud, then the new eligibility rules would have an impact.

6. We are reviewing the current approach to apportionment of PC fees and Compensation Fund contributions, as well as levels of other fees paid to the SRA for specific regulatory activities. There are a number of dependencies for this activity in particular the delivery of a major programme of regulatory reform, including review of the Professional Indemnity Insurance and final phases of CAR. These are expected to impact on the SRA costs and their distribution across individuals and different types of firms we regulate. Therefore we intend to phase the work, addressing the immediate priorities and changes we can implement more quickly, allowing for the second phase to be more aligned to the reformed approach and changes in the market place. Detailed plans and timescales are being finalised.
7. The contributions are not Practising Fees under the Legal Services Act (LSA) 2007, and so approval is required under part 3 of Schedule 4 rather than under s 51 of the LSA 2007.

## **B. Details of the relevant Regulatory Arrangements**

### ***Nature and effect of the existing position***

8. The SRA is required by statute to provide a Compensation Fund to compensate consumers who lose money due to the dishonesty or failure to account of solicitors (REs and RFLs) or recognised bodies. The Law Society's application and subsequent approval to become a Licensing Authority extends the same Compensation Fund provisions to Licensed Bodies. This required statutory amendments under s69 LSA 2007 which were made after the necessary consultation by the Legal Services Board (LSB).
9. The statutory powers permit the SRA to require the regulated community to contribute to the Compensation Fund. The Compensation Fund Rules require both regulated individuals and regulated firms to make an annual contribution, collected mainly during the annual renewal/data collection exercise. Payment is required by 31 October for the following practising year.
10. In the absence of any evidence to suggest that the current approach to the apportionment of Compensation Fund contributions is fundamentally flawed, and given that the review of compensation arrangements is ongoing, it is proposed that the arrangements for the collection of the Compensation Fund contributions remain the same as previous years. This proposal supports principles: 3 (predictable income) and 4 (stability) of the fees policy.
11. Each year the SRA Board reviews the funding requirement for the following practising year and sets the individual and firm contributions at a level which ensures that the funding requirement is met. The contributions are required to fund the cost of claims, reserves and the cost of handling the claims. The SRA Finance and Resources Committee reviews the claims experience, level of reserves and budget for staff to handle the claims before making a recommendation to the SRA Board. The SRA Board then makes a recommendation to the Law Society Council which is required, under the General Regulations, to approve the overall funding requirement. The SRA Board then makes the final decision on apportionment and sets out the contribution by resolution (the Compensation Fund determination).

### **C. Nature and effect of the proposed change**

12. The Finance and Resources Committee, having gone through a detailed review, recommended that the funding requirement for 2015/16 should be £8.5m. The basis of this recommendation is included as Annex A which sets out the relevant financial analysis to support the £8.5m requirement. SRA Board considered this on 3 June 2015 and Management Board on 10 June 2015 and both approved the same. It was subsequently approved by the Law Society Council on 8 July 2015. The SRA therefore now seeks the approval by the LSB of the following determinations:

#### ***Annex B: Draft Determination of Compensation Fund contribution 2015***

- This prescribes the individual and firm Compensation Fund contribution.

#### ***Annex C: Draft Determination of Compensation Fund contributions for Licensed Bodies 2015***

- This prescribes the contribution payable by the Licensed Bodies.

### **D. Rationale for level of contribution**

13. The funding requirement for the Compensation Fund will vary year on year depending on claims experience. The proposed level of contribution has been calculated in line with the methodology used in previous years and refined to take account of relevant, more specific information where available, with consideration being given to additional high risk potential liabilities.

14. Over the years there have been variations with sometimes significant increases, for example, during property recessions. The reserving policy referred to in the Annex A, and forward forecasting seeks, as much as possible, to avoid large swings and has been refined to take account of relevant, more specific information where available, with consideration being given to additional high risk potential liabilities.

### **E. Statement in respect of the Regulatory Objectives**

15. The existence and effective operation of a Compensation Fund primarily protects and promotes the interests of consumers, in ensuring that they receive compensation if their money is lost or not accounted for while in the hands of a solicitor or firm. However it also promotes the public interest and improves access to justice in giving the public the confidence to entrust funds to solicitors and so facilitate many legal transactions. That is why statute requires such funds to be provided by the legal profession. Given the existence of such funds it is also in consumers' interests to ensure that they are adequately funded and so able to meet claims without undue delay.

### **F. Statement in respect of the Better Regulation Principles**

16. The way in which the Compensation Fund requirement is allocated among the profession was reviewed in 2010 particularly in order to improve transparency and accountability. Following the SRA Board's decision in February 2014 to maintain the PC fees and Compensation Fund contributions apportionment structure for two years, pending a wider review, it was only the amounts that changed. This year the amounts have stayed the same as they were last year. Although the final requirement was not set by the Council until July the SRA's early communications with the profession made it clear that the contributions would remain at the same level as last year, and the on-line calculator, which has been available on the SRA

website, included realistic indicators of the likely contributions. This too has been reported in the legal press.

#### **G. Statement in relation to desired outcomes**

17. The desired outcome in relation to the alteration is to achieve a properly funded Compensation Fund that is able to meet claims as they fall due without undue delay. The Fund is reviewed annually and is also subject to audit. Regular reports on claims experience are made to management and the financial status of the Fund is a key priority for the SRA Finance and Resources Committee.

#### **H. Statement in relation to impact on other Approved Regulators**

18. As there are no changes in the contribution amounts there should not be an impact on other approved regulators.

#### **I. Implementation Timetable**

19. The SRA Board and the Law Society Council finalised the total funding requirements in July and seek LSB approval. During August final preparations for this year's renewal exercise will be made and on 1 October 2015 firms and individuals will be contacted and asked to make the various renewal applications on line and submit the relevant Compensation Fund contributions and other fees by 31 October 2015.

#### **J. Stakeholder engagement**

20. As is standard practice, a comprehensive communications plan was drawn up to support the decision by the SRA Board that there should be no changes to the 2015/16 practising fees structure, including the proportion of Compensation Fund contributions. The purpose of the communications plan was to ensure that the regulated community and relevant stakeholders were informed of:
  - The 2015-16 fees structure
  - The availability of the fees calculator to help them
21. The following elements of the communications plan for fees and compensation fund activities had been delivered or are scheduled for delivery:
  - Fee-payers were invited to comment on the SRA's strategic priorities for 2015-16, having direct input into the planned activities and their associated costs
  - An outline of the fee structure for practising fees for this year was announced in the SRA's newsletter to the profession, SRA Update, which is sent to 200,000 recipients, including all those with a mySRA account. This announcement was sent out in April 2015
  - The verification process for the turnover figures submitted online by firms as part of the renewals process was promoted through Compliance News, a dedicated e-newsletter for compliance officers, in May, and again in the June issue of SRA Update
  - The June SRA Update also promoted the Law Society's consultation on fees
  - Updated fees pages on the SRA website (with caveat that LSB still needs to approve).
  - Publication of the on-line calculator
  - A media release on the SRA Board's decision on fee determinations
  - The decision will be promoted through SRA Update on 21 July 2015

- Following a well-received addition to last year's fees-setting process, the Chair of the SRA Board will write to the senior partner of all SRA-regulated firms on a date to be determined to outline key points from the 2015-16 budget
- Assuming the LSB approves the budget requirement of the Law Society Group, that decision will be publicised in a media release in mid-August
- As is the Communications Unit's practice, all news releases are circulated to groups such as the Sole Practitioners' Group, the Association of Women Solicitors, and the Association of Black Lawyers, for publication in their in-house newsletters and website
- Further standard practice for the Communications Unit is to publicise all news releases through social media channels, namely Twitter and LinkedIn
- There will be reference to the online calculator going live in Professional update
- SRA staff will be informed of availability of online calculator and fee determinations (there are more than 100 solicitors working at the SRA)

Many of these communications will send visitors to the Fees 2015-16 page, that outlines how fees are spent by the SRA and which offers the opportunity for feedback

### **SRA contact for matters relating to this application**

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### **Annex A - Basis of recommendation**

### **Annex B - Draft Determination of Compensation Fund contributions 2015**

### **Annex C - Draft Determination of Compensation Fund contributions for Licensed Bodies 2015**

### **Annex D - Update on File Destruction Court Application**

# ANNEXES



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## **Annex A – Basis of recommendation**

### **Compensation Fund Contribution for 2015/16**

#### **Purpose**

1. To recommend the level of Compensation Fund Contribution for 2015/16 to the Law Society (TLS) Council.

#### **Recommendation**

2. The Board is asked to recommend that TLS Council approves the contributions to the Compensation Fund for 2015/16 totalling £8.5m, resulting in a level of Compensation Fund contribution for 2015/16 of:

- individual contribution - £32; and
- firm contribution - £548.

**If you have any questions about this paper please contact: David Middleton, Executive Director. Legal and Enforcement and Client Protection, david.middleton@sra.org.uk – 0121 329 6003**

## Compensation Fund Contribution for 2015/16

### Background and Approach

3. The Compensation Fund pays discretionary grants to people who have lost money as a result of dishonesty or failure to account by solicitors or law firms. In 2013/14, the Fund paid out £23.8m in grants. It also has a fairly new jurisdiction to pay discretionary grants to people who cannot recover damages from a solicitor or law firm because of a failure to obtain indemnity insurance. That was put in place in view of the abolition of the Assigned Risks Pool which provided similar cover. Very little has been paid out under the new jurisdiction. It is referred to as “uninsured loss” in this paper.
4. Each year, the Board decides how much to raise from law firms and individuals to fund the Compensation Fund.
5. The proposed contributions this year are the same as last year:
  - individual contribution - £32; and
  - firm contribution - £548.
6. It is the long standing approach of the Fund, agreed by the F&RC and the Board, to maintain a minimum reserve fund as a contingency against unexpectedly high numbers of claims or unexpectedly large claims. In addition, our approach in recent years has been to look beyond the practising year in question to try to forecast contribution requirements over a three year cycle to avoid the position (which has occurred in the past) of the contribution spiking and then dropping significantly in consecutive years.
7. As the contribution paper last year pointed out, it would have been possible to have no contribution in the current practising year and still to have maintained a level of reserve well above the identified minimum. This remains the case for the next year.
8. However, a nil contribution in any year would mean that the level of contribution required in the following two practising years would then be significantly higher. Such peaks and troughs in the contribution make planning difficult for law firms. The figures show that no contribution is required to maintain the minimum reserve for the next year, but this would mean the requirement in 2016/17 and 2017/18 would be £9.2m and £17.8m respectively to maintain the minimum reserve, leading to much higher contributions.
9. In addition, a nil contribution model would not include any potential additional liability for the uninsured loss jurisdiction (above the sum provided for) and the contentious cases identified in the paper. As a result, the Fund’s reserves would reduce significantly creating a risk in the event of these, or other unforeseen liabilities, arising.
10. By taking an average of the required contribution across a 3 year period, we are able to smooth the impact of the contribution while maintaining a level of minimum reserves which can be used against potential liabilities arising from uninsured firms, contentious matters and so on. We therefore believe that this approach should be continued and this paper has been prepared on that basis.

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### **Position as at 31 March 2015**

11. Total grant payments for the practice year 2013/14 were £23.8m.
12. Forecast payments for this practice year are £16.2m as discussed further below.
13. The gross value of open claims<sup>1</sup> received as at 31 March 2015 was £45.5m. We forecast that of these, we will pay grants in the region of £4.9m, of which £4.2m will be paid in this practising year. It is normal for the gross value to be much higher than what is eventually paid.
14. The value of open claims has remained fairly consistent over the last 12 months as can be seen from Annex 1. A spike in claims in February 2015 was due to 3 claims with original claim values totalling £45.0m. These claims have been closed at the moment as the claimants are pursuing legal remedies. They are referred to briefly below.
15. The Board may recall that we previously separated out mortgage fraud claims but this is no longer necessary due to the very small number of them.
16. The introduction of eligibility criteria will protect the Fund against lender and other corporate claims although in a relatively benign conveyancing market, there are few such claims and so the financial impact at present is low. The categories of claimant who will now be ineligible were rarely successful with their applications as they were usually unable to show hardship. However, should there be, for instance, another sharp rise in claims from lenders due to mortgage fraud, then the new eligibility rules would have an impact.

### Claims for uninsured loss

17. These are applications to the Compensation Fund (following closure of the ARP at the end of September 2013) for losses suffered as a result of the civil liability of a firm which failed to secure a policy of qualifying insurance against which claims could be made. Capita deals with these claims on our behalf because of their close relationship to formal negligence claims which they also dealt with as manager of the ARP.
18. As at 31 March 2015, there have been 71 claims in total, of which 44 are under investigation with a total claim value of £4.4m. The two largest open claims account for £3.3m. One of these is for £1.3m but the likely outcome is assessed at £135k. In other cases where the investigation is sufficiently advanced to make an assessment, the anticipated payment from the Fund is £291k. Some 27 claims have been closed with four payments having been made totalling £5.4k.
19. Last year £2.5m was included for expected payments for 2014/15 to cover possible payments for the open cases and associated defence costs. For 2015/16 £2.0m has been included.

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<sup>1</sup> Sometimes referred to as Original Claims Value (OCV) which after analysis is usually reduced to Revised Claims Value (RCV) which represents a more realistic estimate of the correct value of the claim. Claimants often seek much more “compensation” than is actually payable from the Fund.

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### Contentious Matters

20. Because the Fund is a fund of last resort, it will not pay if the defaulting firm's indemnity insurer should pay. The Board may recall the very high value dispute about this between the Fund and insurers in the Willmetts case. There are a number of cases in which there is an ongoing dispute about whether the indemnity insurers are liable to clients. If not, then these claims may fall on the Fund. Willmetts is the largest case and is in the public domain. Insurers could have liability in the tens of millions. The issue is whether they can rely on the aggregation clause in the minimum terms and conditions. The case is adjourned and the risk of substantial claims being payable by the Fund is mitigated by its discretionary nature.
21. There are other cases with similar issues but they are not sufficiently advanced to represent a serious risk to the Fund for 2015/16. The applications totalling £45.0m referred to in paragraph 14 above are also unlikely to impact on the Fund during 2015/16 and may also be mitigated by the appropriate exercise of discretion on the evidence when it is fully collected. They are part of a larger alleged fraud and further applications may be received.
22. We have therefore not included specific provision in the model for these cases as we think that the sum held above the minimum reserve would be sufficient to cover any potentially payable claims in 2015/16. This is explained in further detail below. There is an element of risk in this approach since whether or not applicants pursue their claims is outside of our control and this is the basis for the recommended contribution.

### Other Payments from the Fund

23. It has previously been agreed by the Board that the costs of interventions (in excess of the SRA budget) could be paid from the Fund.<sup>2</sup> That was in fact the case for many decades so far as the legislation allowed.
24. This has increased the total amount paid out of the Fund in recent years which has a consequent impact on the minimum reserve calculation. Increased costs are also being incurred for Capita in dealing with claims for uninsured firms (see para 17).

### **Calculation of Recommended Contribution for 2015/16**

25. As in previous years, the recommended contribution has been calculated by taking the opening balance of money held in the Fund and then taking account of:
  - calculation of the minimum reserve required (see paragraph 33)
  - forecast cash outflows (i.e. grants and costs – see paragraph 34)
  - forecast cash inflows (excluding the contribution – see paragraph 46)
26. This leads to the required contribution being identified as a balancing figure which is explained in Annex 2 and then as shown in the tables at Annexes 3 and 4. Annex 4

<sup>2</sup> As expressly provided for in the Solicitors Act 1974 (as extended by the Legal Services Act 2007).

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shows the deliberate policy to reduce the balance held above the minimum reserve over the next few years to zero by 2017/18. Each of the above categories is considered in detail below.

### Minimum Reserve

27. The calculation used in recent years for the minimum reserve produces the following figure for 2015/16:

$$\begin{aligned}
 & (1.5 \times \text{weighted average grants in previous 7 years}) + (3 \text{ months' costs paid from the Fund}) \\
 = & (1.5 \times \text{£}17.1\text{m}) + (\text{£}2.7\text{m}) \\
 = & \text{£}28.4\text{m}
 \end{aligned}$$

Cash outflows

*(Note: Red arrows in the original image point from 'grants' and 'costs paid' to 'Cash outflows')*

See Annex 5 for detailed calculation of the minimum reserves for forthcoming years.

### Cash Outflows

28. The Fund's main outflows are the payment of grants and of SRA and Law Society costs allowed by the legislation. The grants paid in the practising year 2013/14 were £23.8m as shown in Annex 6. The amount we expect to pay in grants for the practising year 2014/15 is forecast at £16.2m.

Future grants are forecast as follows:

2015/16 - £12.8m

2016/17 - £15.0m

The value of claims and of grants paid is therefore expected to remain at a relatively stable level as shown in Annex 7. The trend in claims paid by calendar year is shown in Annex 8.

### Future Claims and Costs

29. The main factors in forecasting grants are the numbers of current claims and expected future claims. The latter is in turn determined by the expected number of interventions.

30. For the purpose of this calculation, we have assumed that there will be 45 interventions in this and subsequent practising years, which represents the run rate to date this financial year.

31. Interventions also account for the bulk of the costs paid by the Fund. We liaise closely with Supervision on potential interventions to help forecast future intervention costs more accurately (as well as to prepare operationally). However, inevitably, this can only consider the position on investigations already underway which may lead to interventions in the coming months. Forecasting intervention numbers beyond that is very difficult.

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32. As was noted in last year's paper, we are seeing more interventions into firms which are closed in the sense of no longer having live client files but still hold client money and/or archived client files – often in very large numbers. An intervention into a “closed” firm with a large and disorganised archive can cost as much as an intervention into a live firm.
33. The SRA also continues to engage with some very large firms which are in financial difficulty. While intervention is unlikely in these cases, it remains a possibility.
34. Following the recent successful application to court on file destruction, cost savings are forecast to be realised from May 2016 onwards.

#### Future Grants likely to be paid in 2014/15

35. The total original value of open claims at the end of March 2015 is £45.5m. When looking at the revised claim value of open claims, the total as at the end of March 2015 was £17.8m. The total forecast for grants to be paid against these open claims is in the region of £4.9m, of this we forecast that £4.2m will be paid in this practising year.
36. The table below shows what we forecast to pay out in grants during 2014/15. The total is £16.2m made up of £8.2m actual grants paid out from November 2014 to the end of March 2015, £4.2m of grants in relation to current open claims, £2.6m on claims not yet received and £1.2m in relation to uninsured firms:

Actual grants paid to date (Nov'14 to Mar 15)	£8.2m
Forecast grants on open claims	£4.2m
Forecast for grants relating to future claims	£2.6m
Forecast for claims re uninsured firms	<u>£1.2m</u>
Total	£16.2m

37. Open claims have been evaluated to consider the likelihood of the claim being paid and when the payment is likely to be made. A possible future payout has been predicted based on historical payout rates, considering both the claim size and complexity.

#### Future Grants for 2015/16 onwards

38. All future estimated claims have been evaluated using the same methodology as in previous years. In addition, £2.0m has been included as future grants paid from 2015/16 onwards claims under Rule 5 relating to uninsured firms.

#### Costs paid from the Compensation Fund

39. The amount forecast to be paid from the Fund for 2014/15 is £10.3m based on the intervention costs included in the SRA budget. For 2015/16 the predicted recharge is £10.8m. This is made up of £7.0m intervention costs and the remainder is staff related costs. By way of comparison the costs in 2013/14 were £6.8m. The table at Annex 9 shows a breakdown of all costs recharged to the Fund.

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### Cash Inflows

40. The main cash inflows to the Fund (excluding contributions) are transfers from Statutory Trust Accounts (STAs) through rights of subrogation and the transfer of residual balances.
41. Based on evidence of previously closed STAs and the ongoing work on live accounts, subrogated and residual funds are expected to total £11.1m in this year and £16.0m next year.

### **Assumptions and Risks**

42. The following assumptions have been made in preparing this paper:
  - 45 interventions in this practising year and each year thereafter;
  - the costs payable from the Fund will be £10.8m of which £7.0m are intervention costs and the balance are staff related costs; and
  - rates of recovery from existing and future statutory trust accounts will not differ significantly from previous years.

### Risks and Mitigation

43. Any departure from the assumptions above may result in lower than expected inflows to the Fund or higher than expected outflows, both of which would result in lower than expected reserves.
44. These assumptions are based on information available at the time of writing. The underlying assumptions surrounding the forecast are regularly reviewed to ensure that there have been no significant changes that will affect the Fund in the future. Overall, the risk to the Fund of increased outflows or reduced inflows is mitigated by maintaining a robust reserve.

### **Recommended 2015/16 contribution**

45. By adopting the 3 year average there would be a required contribution of £9.0m, which represents an increase of £0.6m on the amount for the last practising year of (£8.4m).
46. For the purposes of calculating an individual and firm contribution it has been assumed that there will be the equivalent of 132,094 individuals paying a contribution and approximately 7,779 firms paying a contribution.
47. Based on these figures, a collection of £9.0m would result in an individual contribution of £36 and a firm contribution of £548, assuming that the current mechanism for collecting fees is retained (compared to £32 for individuals and £548 for firms last year). See Annex 10.

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48. However, it is recommended that we do not increase the individual fee by £4 this year and that the same fee is collected as last year. Overall this means we will collect £8.5m (£510k less than the £9.0m the model suggests), but we consider that this is low risk and manageable for the Compensation Fund. This move would also be perceived favourably by the profession in terms of the cost of regulation.
49. A comparison of year forecasts presented to the F&RC and SRA Board in recent years with actual position shows a significant favourable variance to forecast. For the three years considered by the 2011 forecast the actual position was £20.2m favourable, for the three years considered by the 2012 forecast the actual position was £13.8m favourable and for the three years considered by the 2013 forecast the actual is now expected to be £17.9m favourable.
50. This shows that the actual position has been significantly more favourable to forecast in each of the periods reviewed. The variances can be explained but show the general approach to forecasting has been cautious in previous years which should give the Board some comfort when recommending the proposed level of contribution.
51. On 30 April 2015 the SRA's Finance & Resources Committee (F&RC) approved the approach for the calculation of contributions to the Fund in line with the method used in previous years and at its meeting on 14 May 2015 the F&RC approved the recommendations in this paper.
52. Following the Board's decision in relation to the proposed funding levels for the 2015/16 Compensation Fund contribution, the matter will be considered by Management Board on 10 June 2015 and Law Society Council at its meeting in July 2015.

**Recommendation: The Board is asked to recommend that TLS Council approves the contributions to the Compensation Fund for 2015/16 totalling £8.5m, resulting in a level of Compensation Fund contribution for 2015/16 as:**

- **individual contribution - £32; and**
- **firm contribution - £548.**



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### **Links to the Strategic Plan and / or Business Plan**

53. This paper relates to our strategic objective to “improve our operational performance and make fair and justifiable decisions promptly, effectively and efficiently” in the context of ensuring client protection through an effective and efficient Compensation Fund.

### **How the issues support the principles of better regulation**

54. A properly run Compensation Fund provides transparency and accountability.

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

55. The paper has been shared with Finance in Corporate Solutions.

### **What equality and diversity considerations relate to this issue**

56. There are no equality and diversity considerations relevant to this paper.

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**Date** 06 May 2015

### **Annexes**

Annex 1	Original claim value (OCV) of work in progress (WIP), receipts and closures April 2013 - March 2015
Annex 2	Compensation Fund contribution shown as a balancing figure
Annex 3	Compensation Fund: 2013/14 - 2014/15 (Budget and Forecast)
Annex 4	Compensation Fund: 2014/15 - 2015/16 - 2016/17 - 2017/18
Annex 5	Minimum reserve calculations
Annex 6	Compensation Fund year end balances and grants paid
Annex 7	Original claim values and claims paid 2005-2014
Annex 8	Compensation Fund claim payments by calendar year
Annex 9	Costs recharged to the Fund
Annex 10	Compensation Fund funding requirements and indicative contributions

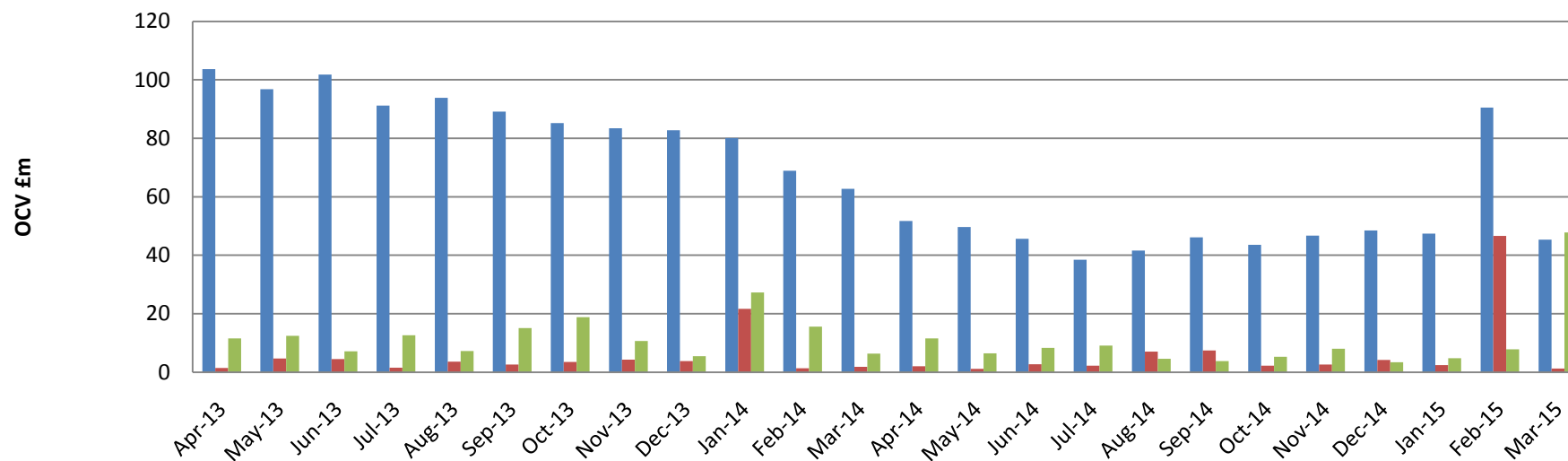


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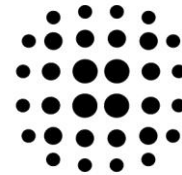
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Annex 1

Original claim value (OCV) of WIP, receipts and closures April 2013 - March 2015



	Apr-13	May-13	Jun-13	Jul-13	Aug-13	Sep-13	Oct-13	Nov-13	Dec-13	Jan-14	Feb-14	Mar-14	Apr-14	May-14	Jun-14	Jul-14	Aug-14	Sep-14	Oct-14	Nov-14	Dec-14	Jan-15	Feb-15	Mar-15
OCV of WIP	103.7	96.8	101.8	91.2	93.8	89.1	85.2	83.4	82.7	80.1	68.9	62.7	51.7	49.6	45.6	38.5	41.6	46.1	43.6	46.7	48.5	47.4	90.5	45.3
OCV of Receipts	1.4	4.7	4.5	1.5	3.6	2.6	3.5	4.3	3.8	21.7	1.3	1.8	2	1.1	2.7	2.2	7	7.4	2.2	2.6	4.2	2.4	46.6	1.2
OCV of Closures	11.5	12.4	7.1	12.6	7.2	15.1	18.8	10.7	5.5	27.3	15.6	6.3	11.5	6.4	8.3	9.1	4.6	3.8	5.3	8	3.4	4.8	7.8	47.8



Annex 2

Compensation Fund contribution shown as a balancing figure

	Basis of calculation
Opening balance	As per accounts
<b>Less Cash Outflows:</b>	
Compensation Fund grants paid	Forecast based on work in progress, historical payout rates, expected future claims based on historical claim numbers and expected number of interventions.
Fees, taxes and other charges	Expected tax and audit costs
SRA support costs recharged	SRA budget / forecast figures
<b>Add Cash Inflows:</b>	
Subrogated claims	Expected receipts from existing Statutory Trust Accounts (STAs) based on historical distributions as well as forecast receipts from STAs in relation to future interventions.
Compensation Fund recoveries	Assumed to be broadly in line with previous years.
Residual funds	Expected receipts from existing Statutory Trust Accounts (STAs) based on historical distributions as well as forecast receipts from STAs in relation to future interventions.
Bank & investment income	Expected balances in the Fund and rates of return on investments
<b>Compensation Fund Contribution</b>	<b>Balancing figure</b>
Closing balance = Minimum Reserve	Calculation based on formula

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## Annex 3

## Compensation Fund budget and forecast 2014-2015

2013/14 Actual	2014/15 Full Year Budget	Compensation Fund forecast 2014-2018 £000's	PY 14-15		
			Actual November - March	Forecast April - October	Full year forecast
£72,037	£55,897	<b>Opening balance as at 1st November</b>	£56,010	£49,160	<b>£56,010</b>
		<b>Cash Outflows</b>			
£23,787	£12,172	Compensation Fund Grants	£8,200	£8,042	<b>£16,242</b>
£38	£122	Fees, tax and other costs	£10	£22	<b>£32</b>
£10,611	£11,740	SRA support costs recharged	£3,828	£6,471	<b>£10,300</b>
<b>£34,437</b>	<b>£24,034</b>	<b>Total cash outflow in period</b>	<b>£12,038</b>	<b>£14,535</b>	<b>£26,573</b>
		<b>Cash inflows</b>			
£6,246	£4,696	Subrogated claims	£2,363	£7,118	<b>£9,481</b>
£191	£142	Compensation Fund recoveries	£204	£98	<b>£303</b>
£1,785	£1,013	Residual balances from STA's	£188	£1,415	<b>£1,603</b>
£218	£293	Bank & investment income	£38	£127	<b>£165</b>
<b>£8,440</b>	<b>£6,144</b>	<b>Total cash inflow before contributions</b>	<b>£2,792</b>	<b>£8,759</b>	<b>£11,552</b>
- <b>£25,996</b>	- <b>£17,891</b>	<b>Net cash inflow / outflow before contributions</b>	<b>-£9,245</b>	<b>-£5,776</b>	<b>-£15,022</b>
£46,041	£38,007	<b>Balance before contributions</b>	£46,765	£43,384	<b>£40,988</b>
£9,970	£8,395	<b>Compensation Fund contributions</b>	£2,396	£0	<b>£2,396</b>
- <b>£16,026</b>	- <b>£9,495</b>	<b>Net cash inflow after contributions</b>	<b>-£6,850</b>	<b>-£5,776</b>	<b>-£12,626</b>
<b>£56,011</b>	<b>£46,402</b>	<b>NET BALANCE AFTER CONTRIBUTIONS</b>	<b>£49,160</b>	<b>£43,384</b>	<b>£43,384</b>

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Annex 4



Compensation Fund forecast 2014-18

	PY 14-15	PY 15-16	PY 16-17	PY 17-18
<b>Compensation Fund forecast 2014-2018 £000's</b>	<b>Full year forecast</b>	<b>Full year forecast</b>	<b>Full year forecast</b>	<b>Full year forecast</b>
<b>Opening balance as at 1st November</b>	<b>£56,010</b>	<b>£43,384</b>	<b>£45,295</b>	<b>£35,957</b>
<b>Cash Outflows</b>				
Compensation Fund Grants	£16,242	£12,811	£15,042	£16,571
Fees, tax and other costs	£32	£38	£38	£38
SRA support costs recharged	£10,300	£10,753	£10,806	£10,863
<b>Total cash outflow in period</b>	<b>£26,573</b>	<b>£23,603</b>	<b>£25,886</b>	<b>£27,472</b>
<b>Cash inflows</b>				
Subrogated claims	£9,481	£13,454	£5,888	£7,625
Compensation Fund recoveries	£303	£269	£269	£269
Residual balances from STA's	£1,603	£2,523	£1,124	£1,468
Bank & investment income	£165	£248	£248	£248
<b>Total cash inflow before contributions</b>	<b>£11,552</b>	<b>£16,494</b>	<b>£7,529</b>	<b>£9,610</b>
<b>Net cash inflow / outflow before contributions</b>	<b>-£15,022</b>	<b>-£7,108</b>	<b>-£18,357</b>	<b>-£17,862</b>
<b>Balance before contributions</b>	<b>£40,988</b>	<b>£36,276</b>	<b>£26,937</b>	<b>£18,095</b>
<b>Compensation Fund contributions</b>	<b>£2,396</b>	<b>£9,019</b>	<b>£9,019</b>	<b>£9,019</b>
<b>Net cash inflow after contributions</b>	<b>-£12,626</b>	<b>£1,911</b>	<b>-£9,338</b>	<b>-£8,843</b>
<b>NET BALANCE AFTER CONTRIBUTIONS</b>	<b>£43,384</b>	<b>£45,295</b>	<b>£35,957</b>	<b>£27,114</b>
variance from minimum reserve after contributions	£12,801	£16,874	£8,825	£0
<b>Calculated minimum reserve:</b>	<b>£30,583</b>	<b>£28,421</b>	<b>£27,132</b>	<b>£27,114</b>

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Annex 5

Minimum Reserve Calculations

<i>Minimum reserve calculation: grants paid last 7 years</i>	Contribution Year			
	2014/15	2015/16	2016/17	2017/18
<b>Practising year ↓</b>				
2008/09	£13.5 m	£13.5 m		
2009/10	£28.3 m	£28.3 m	£28.3 m	
2010/11	£15.4 m	£15.4 m	£15.4 m	£15.4 m
2011/12	£17.3 m	£17.3 m	£17.3 m	£17.3 m
2012/13	£15.8 m	£15.8 m	£15.8 m	£15.8 m
2013/14	£23.8 m	£23.8 m	£23.8 m	£23.8 m
2014/15 (forecast)	£16.2 m	£16.2 m	£16.2 m	£16.2 m
2015/16 (forecast)	N/a	£12.8 m	£12.8 m	£12.8 m
2016/17 (forecast)	N/a	N/a	£15.0 m	£15.0 m
2017/18 (forecast)	N/a	N/a	N/a	£16.6 m
Weighted average	£18.6 m	£17.1 m	£16.3 m	£16.3 m
Average * 1.5	£27.9 m	£25.7 m	£24.4 m	£24.4 m
3 months recharge	£2.7 m	£2.7 m	£2.7 m	£2.7 m
Minimum reserve	£30.6 m	£28.4 m	£27.1 m	£27.1 m

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**Annex 6**

**Compensation Fund year end balances and grants paid**

<b>Year</b>	<b>Grants paid</b>	<b>Year end balance</b>
2009-10	£28.3 m	£56.2m
2010-11	£15.4 m	£44.9m
2011-12	£17.3 m	£47.7m
2012-13	£15.8m	£72.0m
2013-14	£23.8m	£56.0m

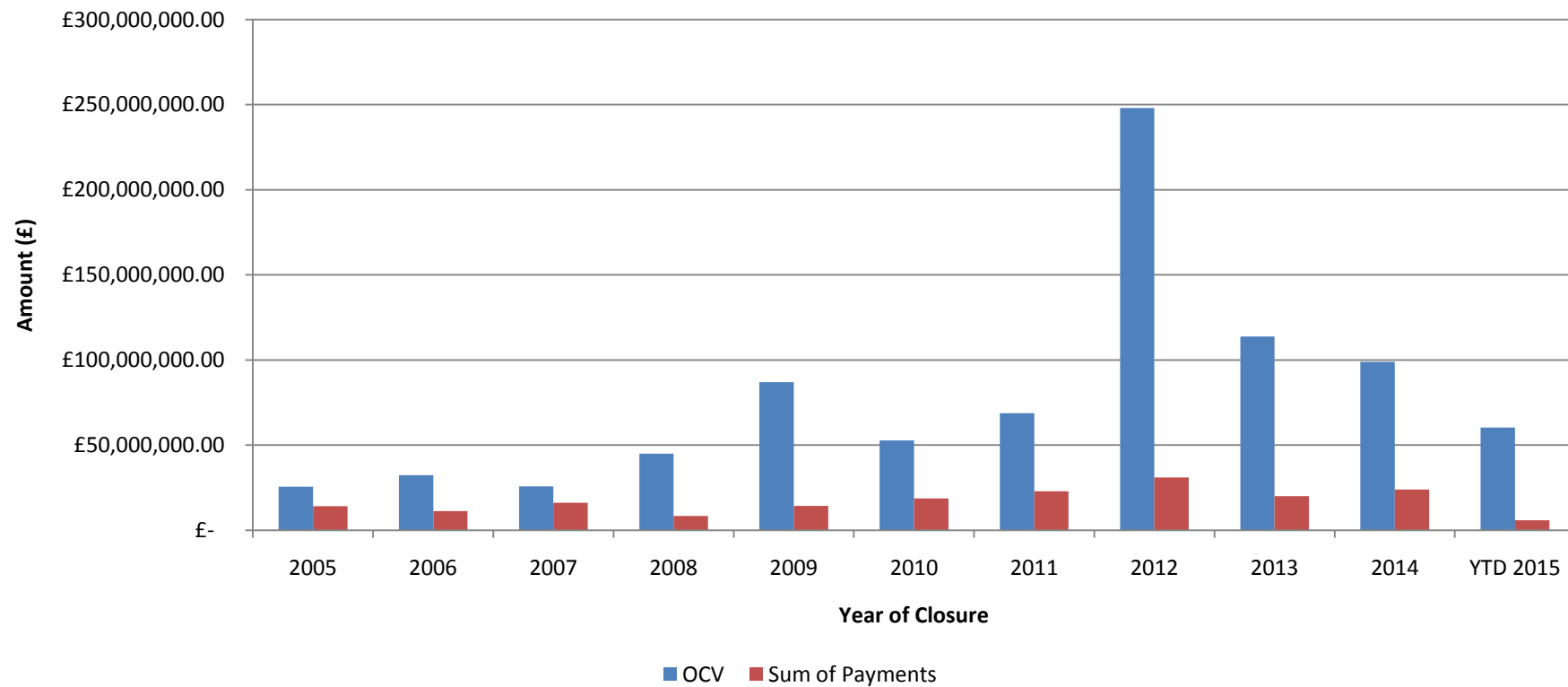


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Annex 7

Original claim values and claims paid 2005-2014



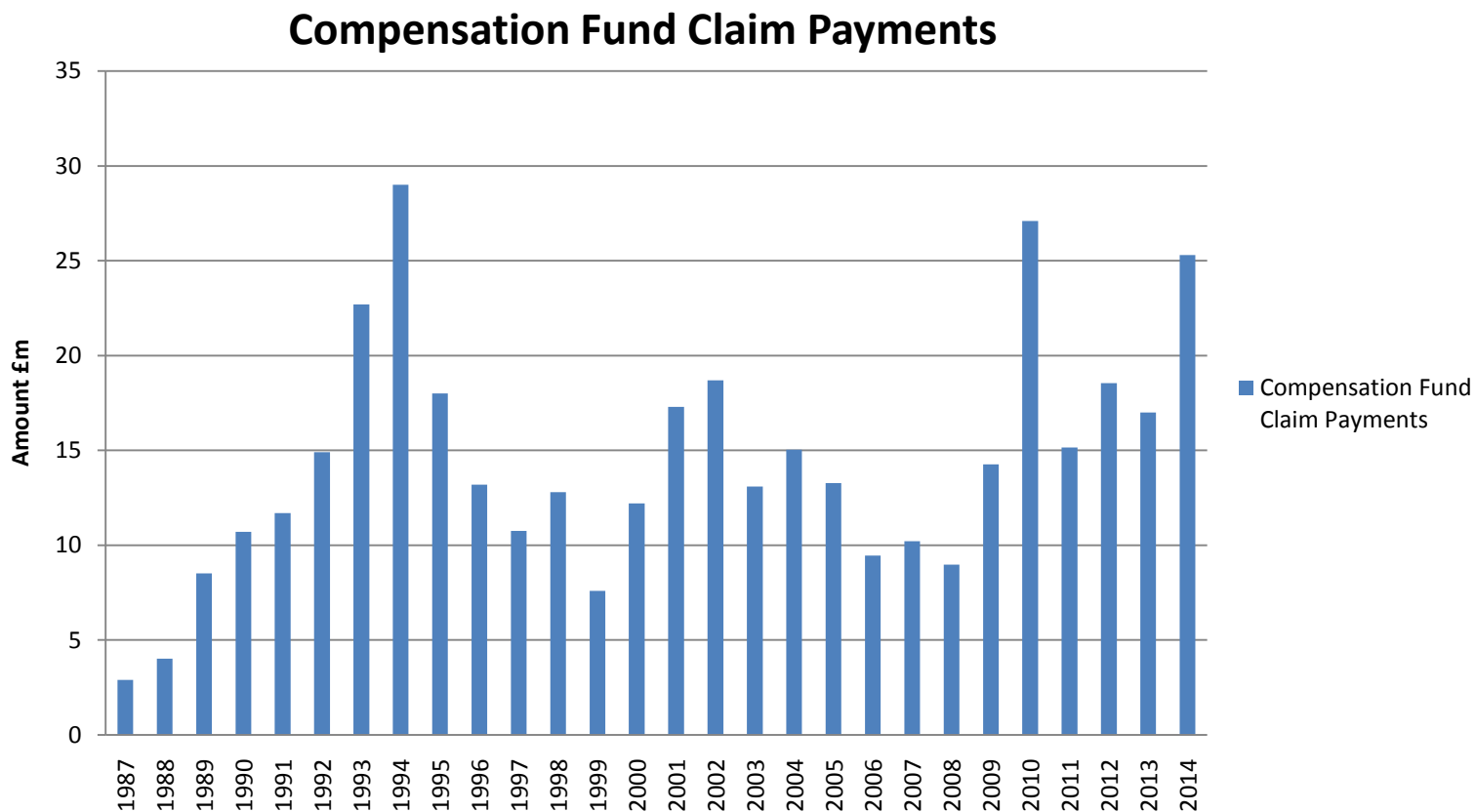




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Annex 8  
Compensation Fund claim payments by calendar year



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**Annex 9**  
**Costs recharged to the Fund**

	2015/16 (£000's)	2016/17 (£000's)	2017/18 (£000's)
Claims Management	1,027	1,053	1,082
Adjudication	48	49	51
Accounts Assessment	480	494	508
DSU	74	76	78
Contact Centre	100	100	100
Interventions	7,041	7,051	7,061
Shared service recharge	1,983	1,983	1,983
<b>Total</b>	<b>10,753</b>	<b>10,806</b>	<b>10,863</b>

	2015/16 (£000's)	2016/17 (£000's)	2017/18 (£000's)
Claims Management	1,027	1,053	1,082
Adjudication	48	49	51
Accounts Assessment	480	494	508
Directorate Support Unit	74	76	78
Contact Centre	100	100	100
Interventions	7,041	7,051	7,061
Shared service recharge	1,983	1,983	1,983
<b>Total</b>	<b>10,753</b>	<b>10,806</b>	<b>10,863</b>

**Annex 10****Compensation Fund funding requirements and indicative contributions**

	<b>Actual 2013-14</b>	<b>Actual 2014-15</b>	<b>2015-16 forecast</b>	<b>2016-17 forecast</b>
Total contribution	13,445,450	8,378,322	9,019,000	9,019,000
Indicative individual Fee	£56	£32	£36*	£36
Indicative firm Fee	£836	£548	£548	£548
Firm / Individual split	50/50	50/50	50/50	50/50

\* It is recommended that the individual fee remains at £32 for 2015-16. Please note these are indicative contributions and may change if the number of firms/ individuals change.

## **Annex B - Draft Determination of Compensation Fund contributions 2015**

This determination is made by the Solicitors Regulation Authority Board under rule 2.3 of the SRA Compensation Fund Rules 2011, with the approval of the Legal Services Board under paragraph 19 of Schedule 4 to the Legal Services Act 2007.

- (1) Every person who applies for a practising certificate to commence on or after 1 November 2015, or who applies for initial registration or renewal of registration as a registered European lawyer or registered foreign lawyer to commence on or after 1 November 2015, shall pay with the fee payable in respect of that application, a contribution of £32 to the Fund.
- (2) Every recognised sole practitioner :
  - (a) whose practice is to be treated as a recognised sole practice from 1 November 2015; and
  - (b) that has held or received client money (as defined in the SRA Accounts Rules 2011) during the period 1 November 2014 to 31 October 2015 shall pay a contribution of £548 to the Fund.
- (3) Every recognised body that has held or received client money (as defined in the SRA Accounts Rules 2011) during the period 1 November 2014 to 31 October 2015, shall pay with the annual periodical fee, a contribution of £548 to the Fund.
- (4) Every person that:
  - (a) applies for initial authorisation as a recognised sole practice or initial recognition as a recognised body to commence during the period 1 November 2015 to 31 October 2016; and
  - (b) intends to hold or receive client money (as defined in the SRA Accounts Rules 2011) at any time during the period 1 November 2015 to 31 October 2016shall pay with the fee payable in respect of that application, a contribution to the Fund as follows:
  - i. £548 on applying for initial recognition to commence in the period 1 November 2015 to 31 December 2016;
  - ii. £411 on applying for initial recognition to commence in the period 1 January 2016 to 31 March 2016;
  - iii. £274 on applying for initial recognition to commence in the period 1 April 2016 to 30 June 2016;
  - iv. £137 on applying for initial recognition to commence in the period 1 July 2016 to 31 October 2016.
- (5) The SRA may waive the contribution payable under paragraph (4) above in circumstances where the initial application is made by a body which is changing its legal status or is

succeeding to the practice of another recognised body or recognised sole practitioner and the predecessor body or practitioner has already paid a contribution to the Fund.

(6) In this determination:

**Fund** means the Solicitors' Compensation Fund established and maintained under rule 2.1 of the SRA Compensation Fund Rules 2011;

**Recognised Sole Practice** means the practice of a solicitor or REL which is recognised by the SRA under section 9 of the AJA; **and**

All other terms are to be interpreted in accordance with the Practising Certificate Fee Determination 2015.

(7) This determination shall come into force on 1 November 2015.

## Annex C - Draft Determination of Compensation Fund contributions for Licensed Bodies 2015

This determination is made by the Solicitors Regulation Authority Board under rule 2.3 of the SRA Compensation Fund Rules 2011, with the approval of the Legal Services Board under paragraph 19 of Schedule 4 to the Legal Services Act 2007.

- (1) Every licensed body that held or received client money (as defined in the SRA Accounts Rules 2011) at any time during the period 1 November 2014 to 31 October 2015, shall pay, with the annual periodical fee, a contribution of £548 to the Fund.
- (2) Every licensed body that intends to hold or receive client money (as defined in the SRA Accounts Rules 2011) at any time from the date on which the body is authorised to 31 October 2016, shall pay, with the initial periodical fee, a contribution to the Fund as follows:
  - i. £548 on being authorised in the period to 31 December 2015;
  - ii. £411 on being authorised in the period 1 January 2016 to 31 March 2016;
  - iii. £274 on being authorised in the period 1 April 2016 to 30 June 2016;
  - iv. £137 on being authorised in the period 1 July 2016 to 31 October 2016.
- (3) The SRA may waive the contribution payable under paragraph (2) above in circumstances where the initial application is made by a body which is changing its legal status or is succeeding to the practice of a recognised body or recognised sole practitioner and the predecessor body or practitioner has already paid a contribution to the Fund.
- (4) In this determination:

**Fund** means the Solicitors' Compensation Fund established and maintained under rule 2.1 of the SRA Compensation Fund Rules 2011; and

All other terms are to be interpreted in accordance with the Licensed Body Fee Determination 2014.
- (5) This determination shall come into force on 1 November 2015.

## **Annex D - Update on File Destruction Court Application**

1. Last year, the SRA made an application to Court to clarify the extent of its powers relating to old files and papers taken into its possession on intervention. It is common on an intervention for the SRA to take possession of files which are many years old and the provisions of the Solicitors Act relating to intervention powers were not clear on the SRA's ability to destroy those papers.
2. Over 6 million such files were held in intervention archives with ongoing storage costs.
3. In November 2014 the hearing took place with judgment being handed down in February 2015. The judge gave express permission for the SRA to destroy all files in its possession at that point in accordance with its published policy (which provides for different retention periods for different types of files). The judge also then confirmed that the SRA has an implied power under the Act to destroy files in future without the need to bring further applications to Court.
4. A rolling programme of destruction has therefore now been implemented. The actual destruction is undertaken by Capita in compliance with strict requirements around confidentiality. To date, the SRA has authorised the destruction of just under 1 million files and these will be destroyed in the coming months.
5. Initially, this will increase the costs to the SRA due to the costs of destruction. However, by the middle of next year, the cost savings from reduced storage fees will exceed the destruction costs and therefore savings will begin to accumulate.