Application made by the Solicitors Regulation Authority Board to the Legal Services Board under Part 3 of Schedule 4 to the Legal Services Act for the approval of changes to regulatory arrangements relating to Compensation Fund contributions
25 July 2022

Contents

Application made by the Solicitors Regulation Authority Board to the Legal Services Board under Part 3 of Schedule 4 to 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 2022/23. The methodology used to allocate the cost of the Fund throughout the regulated community remains the same as last year. Regulated individuals will contribute 50% of the funding requirement and regulated firms holding client money will contribute 50%.

2. A contribution level of £9.7m (2021: £11.6m) is required and will result in an individual contribution of £30 (2021: £40) and a firm contribution of £690 (2021: £760). This is a decrease for the fourth consecutive year but, based on the best information available, is set at a level to properly manage the Fund on a sound financial basis.

3. The proposed level of contribution has been calculated in line with our established methodology, which involves assessing expected pay outs 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.

4. The calculation of the contribution uses the best view of predicted numbers and costs of interventions for the remainder of 2021/22 onwards, continuing trends for business as usual and claims in relation to uninsured firms with consideration also being given to any high-risk potential liabilities where known.

5. The contributions are not practising fees under the Legal Services Act 2007 (LSA), and so approval is needed under Part 3 of Schedule 4 rather than under section 51 of the LSA.

B. Details of the relevant regulatory arrangements

Nature and effect of the existing position

6. Under statute, we may maintain a Compensation Fund to compensate consumers who lose money due to the dishonesty or failure to account of solicitors (including RELs and RFLs) or firms. The Compensation Fund applies to all firms we authorise and regulate.

7. 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 conducted in October each year. Payment is required by 31 October for the following practising year.

8. We propose keeping the same arrangement for collecting the Compensation Fund contributions as we have done in previous years (i.e. collecting 50% from solicitors and 50% from firms).

9. Each year, our Board reviews and sets how much individual solicitors and firms should contribute towards maintaining the Fund. The contributions must fund the cost of claims, reserves, and the cost of handling the claims. In coming to its decision, the Board considers information on the nature of claims and any trends, the level of reserves and the budget for staff to handle the claims. The Board then makes the final decision on how the total funding requirement should be divided between individuals and firms and sets out the contribution by resolution (the Compensation Fund determination). The determinations are included at annexes B and C.

C. Nature and effect of the proposed change

10. The Board agreed that the funding requirement for 2022/23 should be £9.7m and that the contributions should be set at £30 for individuals and £690 for firms holding client money. The basis of this recommendation is included at annex A, which sets out the relevant financial analysis to support the need for £9.7m. This was considered and approved on 25 April 2022. We now seek approval of the following determinations from the LSB:

    Annex B: Determination of Compensation Fund contributions 2022

    - This details how much individual and firms must contribute to the Compensation Fund.

    Annex C: Determination of Compensation Fund contributions for licensed bodies 2022

    - This details the contributions licensed bodies must contribute towards the Compensation Fund.

D. Rationale for level of contribution

11. The funding requirement for the Fund will vary year on year, depending on the nature of claims and any trends. The proposed level of contribution has been calculated in line with the established methodology and refined to take account of relevant, more specific information where available, with consideration being given to additional high-risk potential liabilities.

12. Over the years, the level of contribution has varied, with sometimes significant increases, for example, during property recessions. The Compensation Fund contribution level principles[1], which we consulted on in 2020, aim to avoid this in the future.

13. The consultation on the SRA 2020/21 Business Plan included the principles for setting the level of contributions to the Compensation Fund with a view that these principles would inform our fee setting in future years, providing greater clarity for fee payers and helping to explain the rationale behind any changes to the fees over time.

[1] SRA | Compensation Fund contribution level principles | Solicitors Regulation Authority

14. The principles are summarised below and included in full in Annex D.

    Principle one - The overriding principle will be to maintain the viability of the fund.

    Principle two - We will ensure that the professional contributions to the fund are as manageable as possible for those we regulate.

    Principle three - We will collect the contributions to the fund in a way that is manageable for those we regulate.

    Principle four - We will be transparent about the fund monies and their management.

15. In considering the necessary and appropriate level of contributions for 2022/23 the primary objective is, of course, principle one, to maintain the viability of the fund while avoiding significant fluctuation and volatility in contribution levels.

16. Our analysis, based on the best available information, shows that an overall contribution level of £9.7m ensures the viability of the Fund while allowing for a reduction in the individual and firms' contributions. This will be the fourth consecutive year that the contribution has reduced.

17. In making our assessment we consider, the level of reserves in the fund, our best estimates of claims activity in the current and future years as well as other exceptional cases or situations.

E. Statement in respect of the Regulatory Objectives

18. The existence and effective operation of the Compensation Fund primarily protects and promotes the interests of consumers. It makes sure consumers receive compensation if their money is lost or not accounted for while in the hands of a regulated individual or entity. However, it also promotes the public interest and improves access to justice, as it gives the public the confidence to entrust funds to, and therefore use, solicitors' and firms' legal services. It is also in consumers' interests to make sure the Compensation Fund is properly maintained, to meet claims without delay.

F. Statement in respect of the Better Regulation Principles

19. The way in which the Compensation Fund requirement is allocated among the profession was reviewed in 2010. This was, among other things, to improve transparency and accountability.

20. Our more recent work in relation to the setting of the compensation fund contribution principles and the new compensation fund rules (introduced in July 2021) has been based on the better regulation principles. In particular, these changes have sought to ensure that greater transparency and consistency is applied to the contribution levels and the purpose of the fund.

G. Statement in relation to desired outcomes

21. In decreasing the contributions to the Fund, our aim is to make sure it is properly funded and maintained and able to meet claims without delay, in line with the contribution level principles. The Fund is reviewed annually and is also subject to external audit. Regular reports on the nature of claims and any trends are made to our senior management team, and the Fund's financial status is a key priority for our Board.

H. Statement in relation to impact on other approved regulators

22. There is no impact on other approved regulators. The decrease in contribution only applies to individuals and/or firms we regulate.

I. Implementation timetable

23. The timetable is as follows:

    - our Board finalised the Compensation Fund contributions in April and confirmed the determinations at its meeting on 19 July before seeking LSB approval
    - during August, final preparations for this year's renewal exercise will be made, and, from 1 October 2022, firms and individuals will be able to complete the various renewal applications online
    - firms and individuals must pay the relevant Compensation Fund contributions and other fees by 31 October 2022.

J. Stakeholder engagement

24. As is standard practice, a comprehensive communications plan was drawn up to promote the determination of the 2022/23 practising fees, including the proportion of Compensation Fund contributions. The purpose of the communications plan was to make sure that the regulated community and relevant stakeholders were informed of:

    - what their fees pay for
    - the proposed level of fees to be collected.

25. To give the profession and the public the best possible information on our forward work, our proposed budget, our element of the Practising Certificate Fee and the Compensation Fund Contributions, while minimising the burden imposed by multiple consultations, we consulted as a whole on these areas. Our consultation was launched on 6 May and ran until 27 June.

26. We took a multi-channel approach to engagement using traditional media, digital channels, such as webinars, social media and e-newsletters and direct engagement with a wide range of stakeholders through workshops and focus groups.

27. Our aim was to raise awareness of the consultation, encourage formal written responses, while also gathering feedback through direct engagement and on specific points through social media.

28. We promoted the consultation through:

- featuring it as the lead story in our monthly e-newsletter in May and June - SRA Update - which goes out to around 200,000 solicitors
- gaining coverage for the consultation in a range of legal media, including the Law Gazette, Legal Futures and Today's Conveyancer. Our press release has been viewed around 500 times
- promoting on Twitter and LinkedIn which have resulted in around 9,000 engagements – including around 3,500 votes in polls, a specific bite-size accessible animation which was watched 5,366 times, while our interactive webinar, has been watched 269 times.
- promoting at a range of external virtual events.

29. This means in total we engaged with almost 15,000 people through our engagement programme.

30. We spoke directly to a diverse range of solicitors from representative groups including:
    - Sole Practitioners Group
    - Kent Law Society
    - City of London Law Society
    - Association of Asian Women Lawyers
    - Association of Women Solicitors London
    - Birmingham Black Lawyers
    - Society of Asian Lawyers
    - British Ghanaian Lawyers Union
    - British Nigerian Law Forum
    - Black Solicitors Network
    - Society of British Bangladeshi Solicitors
    - UK Chinese Lawyers Association
    - Association of Muslin Lawyers.

31. We have also engaged through a specific charities and consumer representative bodies workshop. This included Diverse Cymru, Wiltshire Law Centre, South West London Law Centres, Hyde Housing Association, Suffolk Law Centre, Support Through Court and the Association of Consumer Support Organisations.

32. And we have spoken to members of the public about our priorities - and their experiences of legal services – through 2 focus groups, making sure the groups included a diversity in terms of background, gender, age and education. One session was with participants from across England and the other from across Wales.

33. We worked with the charity LifeShare in Manchester to hold a focus group with homeless people, who had also experience mental health problems, in Manchester.

34. We also ran a roundtable with stakeholders specifically interested or invested in innovation and technology in the legal sector. Representatives from 26 different organisations attended, including regulated and unregulated legal service providers, as well as tech specialists and entrepreneurs.

35. We also sought the views of non-commercial bodies. Specifically, we:

- sent a targeted email to solicitors working in non-commercial bodies about the consultation and highlighting the proposed practising certificate fee
- ran a workshop for in-houses solicitors that was attended by 20 representatives including both solicitors working in commercial (eg Confused.com, Specsavers, Neptune energy, Aviva) and non-commercial bodies (eg the British Museum, Family Action, NHS Wales Shared Services Partnership).

36. The reduction in the fee was welcomed by those respondees that referred to it.

37. As part of our consultation on the SRA business plan and budget we asked for responses to help build our understanding on the impacts on different groups of solicitors. As part of this feedback we received nothing to suggest that the contributions would have disproportionate impacts on those with protected characteristics.

Contact for matters relating to this application

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Annexes

Annex A - Basis of recommendation

Annex B - Determination of Compensation Fund contributions 2022

Annex C - Determination of Compensation Fund contributions for Licensed Bodies 2022

Annex D – Compensation Fund Contribution level principles

Annex A – Basis of recommendation

Compensation Fund Contribution for 2022/23

1 The SRA Board approved the contribution to the Compensation Fund (“the Fund”) for 2022/23 at £9.7m resulting in:

- Individual contribution £30 (2021/22 - £40)
- Firm contribution £690 (2021/22 - £760)

Background

2 The purpose of the fund was set out fully in the 2020 consultation on the fund rules:

“The SRA Compensation Fund protects consumers of legal services by helping those who have lost money due to fundamental ethical failures by those we regulate. This can be, for example, where the loss was caused by dishonesty or lack integrity of a solicitor. The fund therefore helps to uphold trust in the integrity of the legal profession…”

3 There is no legal right to a grant from the fund. These are discretionary and are limited to certain types of loss, namely where:

- those for whom services are provided have lost money as a result of their solicitor or firm's dishonesty
- the solicitor or firm has misappropriated or otherwise failed to account for their money, or
- they have a claim which should have been covered by the firm's mandatory indemnity insurance, but where the firm has failed to take out a policy of insurance as required to under our rules.

4 It is also important to remember that it is financed by the profession with costs ultimately reflected in the price of services.

5 Every year the Executive team carefully considers and proposes the contribution from the profession to the Compensation Fund. The contributions fund the costs of claims, reserves and the costs of handling the claims themselves, including interventions into firms where client monies and files are at risk.

6 When setting the Compensation Fund contribution level for 2020/21, we developed and consulted on a set of principles (see annex D). These principles are the core considerations for the Board when setting the contribution levels for the Fund.

7 We are therefore using these principles for the basis of the analysis in this report and the recommended levels of contributions.

2022/23 contribution levels

8 It was proposed that the fee levels are set at £30 per individual and £690 per firm. This is a significant reduction from last year’s contributions of £40 and £760 respectively.

9 This will generate total contributions of c.£9.7m based on the current number of practising certificate holders and firms holding client money and would result in forecasted reserves of £35.5m at the end of 2022/23.

10 The proposed levels are in keeping with the principles we consulted on and the Board approved in 2020:

Principle one - The overriding principle will be to maintain the viability of the fund

11 When considering compliance with this overriding principle we have set two key requirements:

I. the proposed fee levels are maintainable over a three year period

II. we aim to bring the balance to within a range of the minimum reserve plus a maximum of £10m.

12 The forecasts demonstrate that maintaining the fee levels at around £30/£690 is sustainable over a three year period based on expected levels of activity.

13 The proposed contribution levels would see a continued reduction in the balance but importantly, in terms of the viability of the Fund, it remains in excess of the required minimum reserve.

14 It is important to recognise that we model against a **minimum** reserve, not a level which needs to be 'achieved'. When setting the contribution and ensuring that we comply with this principle, we need to make sure that we maintain sufficient funds to cover additional risk factors.

15 We consider it prudent and proportionate to maintain a level of reserve that is within a range above the minimum reserve. We have worked on the assumption of a range up to £10m above the minimum reserve being appropriate.

16 Historically we have maintained a balance on the fund in excess of the minimum reserve but we have not previously set a defined range (we have previously seen a balance considerably higher than £10m above the minimum). As detailed below, the proposed range clearly supports this overriding principle to ensure that there is no risk to the viability of the fund. It is also equally important in helping us to comply with the second principle to ensure the contributions are manageable. The proposed range will help us avoid significant variations in the fee year on year while also ensuring reserves do not become excessive.

17 It should also be highlighted that there has been a significant reduction in the balance over the last 12-18 months where the forecasted balance for the end of 2021/22 of £37.6m will be a £13m reduction from the £50.6m held at the end of October 2021.

Principle two - We will ensure that the professional contributions to the fund are as manageable as possible for those we regulate

18 We are proposing a significant reduction in the contributions which will support firms but also ensure that we continue to avoid the risk of significant volatility in future years.

19 This principle requires us to not only ensure contributions are manageable but also "strive to avoid significant fluctuation and volatility in the contribution levels".

20 We have previously seen the contribution levels increase significantly to cover anticipated risk (from £40 in 2017/18 to £90 in 2018/19) and we are keen to avoid a repeat of this.

21 Maintaining a reserve between the proposed range also reduces the risk of a need for substantial increases in the future or even (worst case scenario) mid-year requests.

22 The proposed contributions of £30 for individuals and £690 for firms are the lowest fees charged for the last six years and are significantly below the average over that period.

Year	**2017/18**	**2018/19**	**2019/20**	**2020/21**	**2021/22**	**Average**
Individual contribution	£40	£90	£60	£50	£40	**£56**
Firm contribution	£778	£1,680	£1,150	£950	£760	**£1,064**

Principle three - We will collect the contributions to the Fund in a way that is manageable for those we regulate

23 We will continue to collect the contributions annually, alongside the practising certificate fees and across all the regulated community.

24 It remains to be seen what impact the ongoing Covid-19 pandemic may have on firms of solicitors, but the approach we are taking should ensure that we have retained sufficient and appropriate balances so that there is no need for any additional collections in-year.

Principle four - We will be transparent about the Fund monies and their management

25 The Fund’s financial statements will be published annually.

26 Consistent with last year, we did not consult separately on the contribution levels, as this is a decision to be made by the Board. We instead invited comment on the contribution level within the budget/business plan consultation which ran from 6 May 2022 to 17 June 2022.

New Compensation Fund Rules

27 The new rules were introduced on 5 July 2021 and so this is the first time they have been considered in setting the proposed contribution levels. However, the impact of the new rules in terms of calculating the contributions is still very much dependent on the nature of any future interventions undertaken and therefore the anticipated future grant levels.

28 The fact that the Fund is discretionary and individual payments are capped at £2m per claim means risks posed from extremely large individual claims or groups of claims is manageable.

Annex B - Determination of Compensation Fund contributions 2022

This determination is made by the Solicitors Regulation Authority Board under rule 1.2 of the SRA Compensation Fund Rules 2021, 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 2022, 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 2022, shall pay with the fee payable in respect of that application, a contribution of £30 to the Fund.

(2) Every recognised body or recognised sole practice that has held or received client money (as defined in the SRA Accounts Rules) during the period 1 November 2021 to 31 October 2022, shall pay with the annual periodical fee, a contribution of £690 to the Fund.

(3) Every person that:

(a) applies for initial recognition as a recognised body or initial recognition as a recognised sole practice to commence during the period 1 November 2022 to 31 October 2023; and

(b) intends to hold or receive client money (as defined in the SRA Accounts Rules) at any time during the period 1 November 2022 to 31 October 2023.

shall pay with the fee payable in respect of that application, a contribution to the Fund as follows:

i. £690 on applying for initial recognition to commence in the period 1 November 2022 to 31 December 2022;

ii. £518 on applying for initial recognition to commence in the period 1 January 2023 to 31 March 2023;

iii. £345 on applying for initial recognition to commence in the period 1 April 2023 to 30 June 2023;

iv. £173 on applying for initial recognition to commence in the period 1 July 2023 to 31 October 2023.

(4) The SRA may waive the contribution payable under paragraph (3) 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 authorised body and the predecessor body or practitioner has already paid a contribution to the Fund.

(5) In this determination:

Fund means the Solicitors' Compensation Fund established and maintained under rule 1.1 of the SRA Compensation Fund Rules 2021;

All other terms are to be interpreted in accordance with the Practising Certificate Fee Determination 2022.

(6) This determination shall come into force on 1 November 2022.

Annex C -Determination of Compensation Fund contributions for Licensed Bodies 2022

This determination is made by the Solicitors Regulation Authority Board under rule 1.2 of the SRA Compensation Fund Rules 2021, 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) at any time during the period 1 November 2021 to 31 October 2022, shall pay, with the annual periodical fee, a contribution of £690 to the Fund.

(2) Every licensed body that intends to hold or receive client money (as defined in the SRA Accounts Rules) at any time from the date on which the body is authorised to 31 October 2023, shall pay, with the initial periodical fee, a contribution to the Fund as follows:

i. £690 on applying for initial recognition to commence in the period 1 November 2022 to 31 December 2022;

ii. £518 on applying for initial recognition to commence in the period 1 January 2023 to 31 March 2023;

iii. £345 on applying for initial recognition to commence in the period 1 April 2023 to 30 June 2023;

iv. £173 on applying for initial recognition to commence in the period 1 July 2023 to 31 October 2023.

(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 1.1 of the SRA Compensation Fund Rules 2021;

All other terms are to be interpreted in accordance with the Licensed Body Fee Determination 2022.

(5) This determination shall come into force on 1 November 2022

Annex D – Compensation Fund Contribution level principles

Background

The Compensation Fund contribution level principles should be read alongside the Compensation Fund Rules[2] which set out how the fund operates. The fund requires both regulated individuals and regulated firms to make an annual contribution, collected during the practising renewals period.

There is no legal right to a grant from the fund. These are discretionary and are limited to certain types of loss, namely where:

a. those for whom services are provided have lost money as a result of their solicitor or firm's dishonesty
b. the solicitor or firm has misappropriated or otherwise failed to account for their money, or
c. they have a claim which should have been covered by the firm's mandatory indemnity insurance, but where the firm has failed to take out a policy of insurance as required to under our rules.

We want to make sure that we are managing the fund in as effective a way as possible in light of its statutory purpose, our regulatory objectives and best regulatory practice. And, as its costs are ultimately reflected in the price of services, it is important that our policy and rules in this area make sure that:

a. funds are prioritised and are focused where they are most needed
b. the fund has a clear purpose and priorities, and
c. the fund is operated in a transparent way with decisions being made consistently and against clear, objective criteria.

Every year, our Board carefully considers and sets the contribution from the profession to the Compensation Fund. The contributions fund the costs of claims, reserves and the costs of handling the claims themselves, including interventions into firms where client monies and files are at risk.

The annual contribution level is informed by reviewing past claim levels, significant prospective claims and any trends, making assumptions on volumes and extrapolating historical data to forecast future receipts and payments. This includes looking at data relating to interventions, although it is difficult to estimate future claims against, or amounts recovered from, interventions in progress.

In order to support the transparency of our decision making, we are setting out the four general principles that the Board considers when setting the annual contributions to the Compensation Fund.

Overall, these principles taken together are designed to make sure we balance the need to maintain the viability of the fund with the need for contributions from the profession - the costs of which are ultimately passed onto consumers - to be proportionate.

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[2] SRA | Compensation Fund Rules 2021 | Solicitors Regulation Authority

Principle one - The overriding principle will be to maintain the viability of the fund.

The Compensation Fund is a key consumer protection for people accessing regulated legal services, so it must be financially sustainable. This means that the fund must be, first, sufficient to meet anticipated future demand and to manage a level of unanticipated claims. Second, it must be maintained at a level that does not place unnecessary financial burdens on the profession which funds it, the cost of which is ultimately passed onto consumers.

Principle two - We will ensure that the professional contributions to the fund are as manageable as possible for those we regulate.

In order to help firms and solicitors plan ahead, we will strive to avoid significant fluctuation and volatility in the contribution levels. This means that we must, as set out in principle one, ensure provision is sufficient to cover a level of unanticipated claims as well as anticipated future demand. We will do this by maintaining a reserve that at least covers future demand and takes account of any exceptional cases (such as high value multiple claims), while minimising year-on-year fluctuations. This will protect the firms (and the fund and therefore the public) from the inevitable uncertainties in predicting claims arising in any one year.

Principle three - We will collect the contributions to the fund in a way that is manageable for those we regulate.

We will continue as a matter of general practice to collect the contributions annually, alongside the practising certificate fees, to minimise the burden of administration on firms. In line with the role of the fund in supporting public confidence in regulated firms and the reputation of the profession, we will continue to levy contributions from across all the regulated community. We will aim through the measure set out above to avoid the need to make additional collections in-year.

Principle four - We will be transparent about the fund monies and their management.

In order to make it clear how fund contributions are used, we will publish the Compensation Fund financial statements annually. We will ensure that the profession has the opportunity to comment on future contribution levels by including the proposed level in our consultations on, for example, our business plan or practising fee setting. We will also provide accessible information for the public, including the vulnerable, about the Compensation Fund, how it operates and how to access the fund without using potentially costly professional support.