

By email only (under s203 of the Legal Services Act 2007)



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Dear Paul,

Warning notice issued pursuant to paragraph 21(1)(b) of Schedule 4 to the Legal Services Act 2007

This warning notice issued under paragraph 21(1)(b) of Schedule 4 to the Legal Services Act 2007 (the Act), is to inform the Solicitors Regulation Authority (SRA), that the Legal Services Board (LSB) is considering whether to refuse the SRA's application, submitted on 15 January 2021 (the Application), which seeks approval of alterations to its regulatory arrangements in respect of the new Compensation Fund Rules.

Having considered the Application, the LSB is of the view that the proposed changes raise concerns which need to be addressed and as a result we are considering in accordance with paragraph 25(3)(a) of Schedule 4 to the Act, whether to refuse the application on the basis that:

- granting the application would be prejudicial to the regulatory objectives, in particular, protecting and promoting the interests of consumers, and protecting and promoting the public interest.

Specifically, the LSB considers the SRA's proposed new Compensation Rules include two changes which potentially engage the refusal criteria under paragraph 25(3) of Schedule 4 to the Act, which are:

- to reduce the maximum payment limit for the grant of individual claims from £2m to £500,000, unless there are exceptional circumstance (the "**Individual Cap**"); and

- to exclude claims from “large” charities and trusts with assets or annual income in excess of £2m from eligibility for a grant from the Fund (the “**Charities Threshold**”).

The Individual Cap

Benefit v Detriment analysis

In response to the LSB’s enquiries, the SRA has helpfully provided the LSB with historical data which shows that, if the Individual Cap had been in place since 2010, a small number of consumers would have experienced significant detriment. The SRA has also estimated that, over the same period, authorised persons would have saved an annual average of £2.50 per solicitor and £50 per firm.

Although the LSB recognises the benefit of this proposal, it does not consider that this alone justifies the significant detriment that would be experienced by a small number of consumers. The LSB considers that the SRA should provide further explanation or quantify the wider potential benefits of the Individual Cap that could be realised to offset this significant detriment. Further, the LSB has reflected on the whether the Individual Cap is likely to achieve the SRA’s intended aim of preventing large fluctuations to the compensation scheme’s contribution levels, thereby reducing the regulatory burden of contributions on solicitors and firms but considers there is insufficient evidence to support this at present. On this basis the LSB is unable to currently determine whether there is a net benefit that justifies the Individual Cap and does not trigger any grounds for refusal under paragraph 25(3) of Schedule 4 to the Act.

Comparative data

In its application, the SRA has placed significant weight on the favourable comparison of its proposal against schemes of other professional services and other legal services regulators (such as the ICAEW and CILEx Regulation which also have an individual cap of £500 000). Although we acknowledge the rationale for this approach, we also note that the risk profile (whereby both the risks to consumers and the available resources to fund these compensation schemes) will vary for each regulator, justifying a difference in approach. For example, the SRA’s own data on historic claims demonstrates that a small number of consumers each year would have had their claims capped, some significantly, if the

Individual Cap had been in place. In the absence of evidence that ICAEW and CILEx Regulation have a similar risk profile, it does not follow that the SRA's compensation scheme should be more closely aligned with those of the ICAEW or CILEx Regulation. The LSB also notes that the Council of Licensed Conveyancers' compensation scheme does not have a cap but is exercised on an entirely discretionary basis.

The Charities Threshold

The LSB understands from correspondence with the SRA that the Charities Threshold is proposed in order to align with the existing thresholds in place for private organisations. The LSB further understands that the Charities Threshold is not expected to remedy any burden on the SRA Compensation Fund or provide any other tangible benefit to the scheme. Further, although the SRA has set out its justification for its proposal to apply the same threshold of £2m to assets and income as a proxy for consistency, the LSB considers that additional consideration and explanation of this approach is required. On this basis, the LSB is not currently persuaded that the perceived detriment to Charities and Trusts is justified and will not give rise to detriment to the regulatory objectives.

Further evidence required

In the light of the above, the LSB considers that further evidence concerning the impact of the above two proposals on the regulatory objectives should be obtained to satisfy the LSB that the refusal ground under paragraph 25(3)(a) of Schedule 4 to the Act is not triggered.

The LSB's key observations include the following:

- Further evidence and/or justification is required on the expected benefits of the Individual Cap on the regulatory objectives. This will enable the LSB to fully assess whether or not the Individual Cap is prejudicial to the regulatory objectives. Further evidence could include projections of future claims in the current economic environment and demonstrate the impact on the Compensation Fund both with and without the Individual Cap. Such evidence would assist the LSB to understand whether and to what extent the Individual Cap may be seen to reduce a barrier to entry to the legal services market and/or assist to reduce the cost of legal services to the consumer if any cost savings are passed on.

- Related to the above point, an explanation and consideration of the impact of alternative individual cap levels on the regulatory objectives, and comparison with the proposed limit.
- Any further evidence to support the Individual Cap (such as consultations with consumer groups).
- Further evidence and/or justification is also required to explain the expected benefits of the Charities Threshold and why the SRA proposes to apply the same threshold of £2m to assets and income.

Warning notice process

Paragraph 22(1) of Schedule 4 to the Act and paragraph 20 of the Rules provides that where a warning notice has been issued, the Board may seek advice about whether the application should be granted. At this stage, we envisage that it may be necessary to seek such advice from the Charities Commission and other experts. The Board will make a decision based on the evidence presented in the Application, together with any further evidence submitted and advice received.

The effect of the warning notice is to extend the decision period in which the LSB can consider the application. Paragraph 26(3) of Schedule 4 to the Act provides that the LSB has a period of 12 months from the date you receive this warning notice to continue considering the proposed changes to the SRA's regulatory arrangements. The decision period will therefore expire on 7 April 2022. While the decision period has been extended by 12 months, the LSB would expect to conclude its deliberation before then, subject to proper and full consideration of all the issues.

Yours sincerely

Matthew Hill

Chief Executive