



Summary of decision

The purpose of this summary sheet is to provide a high level and accessible overview of the Legal Services Board's ("LSB") decision. Readers are recommended to read the formal decision notice below for further detail. **This summary is not and should not be taken as a formal part of the LSB's decision notice under the Legal Services Act 2007 (the "Act").**

The LSB's decision is to grant in full the application from the Solicitors Regulation Authority ("SRA") to make changes to its regulatory arrangements in respect of the SRA's new Compensation Fund Rules ("CFR") which is a discretionary fund of last resort and is financed by annual contributions from solicitors and law firms regulated by the SRA.

The SRA's stated aim for the CFR is to provide proportionate consumer protection at a fair and stable cost to the profession, particularly given the changes in the legal market, consumer behaviour and risks. The proposed changes limit the scope of claims to the Compensation Fund, prioritising individuals and small businesses in most need of protection by simplifying the eligibility criteria and application process. The substantive proposed amendments being approved include:

Eligibility

- Charities may only apply for a grant out of the SRA's compensation fund (the "Fund") if they have an annual income net of tax in the most recent financial year of less than £2m. Trustees of a trust may only apply if the asset value is less than £2m. Both limitations are designed to align with the SRA's existing approach to large businesses.
- Financial or hardship tests for eligible applicants are to be removed, save for a discretion to refuse or reduce payments when the SRA considers the loss to be disproportionately low or appropriately compensated elsewhere.

Prioritisation

- Applications for a grant out of the Fund will be limited to people for whom the legal service has been provided and in certain circumstances, the party on the other side of a legal matter.
- The SRA has clarified expectations around the conduct and behaviour of applicants and how they take this into account when deciding whether to refuse or reduce a payment.
- No payments out of the Fund will be made in the event the insurer becomes insolvent.

Payment limits

- A fixed cap of £5m is to be introduced for multiple applications from single or connected events.

Costs

- No grants out of the Fund are to be made with respect to costs associated with making an application to the Fund.
- Payment of litigation costs will only be made in exceptional circumstances.

The LSB notes that the SRA's proposal to introduce a fixed cap of £500,000 for single claims was withdrawn by the SRA during the LSB's assessment.

Following assessment of the SRA application, the LSB concluded that the changes do not meet the refusal criteria in the Act. Consequently, the LSB has approved this application.

The decision notice explains our assessment of the main issues that we considered in reaching our decision. It also outlines the commitments made by the SRA that were relied upon in our assessment and our expectations for the SRA as it implements, monitors and evaluates the new CFR framework.

Decision notice

The Solicitors Regulation Authority application for approval of alterations to its Compensation Fund Rules.

1. The Legal Services Board (“LSB”) has granted an application from the Solicitors Regulation Authority (“SRA”) for approval to changes to its regulatory arrangements in respect of the SRA’s new Compensation Fund Rules (“CFR”) which is a discretionary fund of last resort and is financed by annual contributions from solicitors and law firms regulated by the SRA.
2. The LSB is required by Part 3 of Schedule 4 to the Legal Services Act 2007 (“the Act”) to review and grant or refuse applications by approved regulators to make alterations to their regulatory arrangements. The Law Society is an approved regulator, and the SRA is the regulatory arm to which the Law Society has delegated its regulatory functions.
3. This decision notice sets out the decision taken, including a description of the changes. The notes at page 14 of this notice explain the statutory basis for the decision.

Chronology

- The LSB confirmed receipt of an application from the SRA on 15 January 2021.
- The 28-day initial decision period for considering the application ended on 11 February 2021.
- On 4 February 2021 the LSB issued an extension notice¹ which extended the decision period to 14 April 2021.
- On 7 April 2021, the LSB issued a warning notice under paragraph 21(1)(b) of Schedule 4 to the Act in respect of the proposals to introduce a fixed cap of £500,000 for single claims (‘the Individual Cap’) and removal of eligibility for large charities with an annual income of £2m or more (net of tax) and trusts with assets of £2m or more (‘the Charities and Trusts Threshold’), which extended the decision period to 7 April 2022.
- On 25 May 2021, the SRA withdrew its proposal to introduce the Individual Cap and submitted further evidence in respect of the Charities and Trusts Threshold.
- This decision notice is effective from 14 June 2021.
- The decision notice will be published on the LSB’s website by 16 June 2021.

Background

4. The Compensation Fund (‘Fund’) makes payments to eligible applicants whose solicitors or firms misappropriate or fail to account for the applicant’s money. For applicants to be eligible, no other means of recovering lost money should be available. Each claim is considered on its merits and the SRA can reject or reduce a payment. The SRA has stated that the Fund cannot cover every financial loss caused by a solicitor or replicate the scope of other redress arrangements such as professional indemnity

¹ <https://legalservicesboard.org.uk/wp-content/uploads/2021/02/Extension-Notice-Compensation-Fund.pdf>

insurance (PII), as this was not the purpose envisaged by the Solicitors Act 1974, which established the Fund.

5. The SRA's application proposes a suite of changes to the CFR which the SRA believes will prioritise the individuals and small businesses who need it most. The SRA has also stated that the proposals will ensure that the Fund is more transparent and fairer by becoming more accessible to applicants. The new changes will also assist the SRA to ensure that the Fund remains viable in view of changing economic circumstances, without having to increase contributions from solicitors and firms to disproportionate levels.

Summary of proposed changes

6. The proposed changes to the CFR are summarised below and further analysis is provided in paragraphs 20-81 of the application.
 - (a) Eligibility: Removal of existing hardship tests.
 - (b) Eligibility: Introduction of the Charities and Trusts Threshold.
 - (c) Prioritisation: Limitation of claims to consumers of legal services and in certain circumstances, the party on the other side of a legal matter. Applications will no longer be accepted from barristers and experts.
 - (d) Prioritisation: Conduct of the applicant. The SRA proposes to introduce an explicit statement that a grant may be reduced or refused if there has been any dishonest, improper or unreasonable conduct by the applicant at the time of the loss, and/or when requesting a payment from the Fund. The SRA will also refuse or reduce a payment if the applicant has failed to pursue the application promptly, co-operatively and in good faith.
 - (e) Prioritisation: The SRA proposes to cease making grants that have arisen from an insurer's insolvency.
 - (f) Payments: Applying a fixed £5m cap to multiple applications from single or connected events.
 - (g) Costs: Exclusion of grants for litigation costs other than in exceptional circumstances.
 - (h) Costs: Removing payments for costs associated with making an application to the Fund.
7. This decision notice sets out the key issues (items (b) and (d) to (h)) that we consider to be the most significant in our assessment of the application against the refusal criteria set out in paragraph 25(3) of Schedule 4 to the Act (see paragraphs 12 to 60 below).

Approach to assessment

Stakeholder views

8. It is the practice of the LSB to take account of views communicated to us in correspondence when considering applications. We publish the correspondence we receive on our website alongside the application.
9. During the assessment period, we received correspondence from the Legal Services Consumer Panel (LSCP) in relation to the SRA's proposals. The LSCP accepted that

there was a need for the CFR to be revised, but it considered that the proposals placed a disproportionate level of risk on consumers and were poorly designed. The LSCP's broad concerns centred around a lack of consumer research and evidence to support the proposals. The LSCP also considered that there were no clear plans for monitoring and evaluating the proposals, if approved. It also perceived that there was a lack of transparency as to how the Fund operates, and there was a need for more comprehensive data collection. These issues are considered in our assessment below in paragraphs 12 to 60.

The LSB's assessment

10. During the assessment period and after raising a number of enquiries with the SRA, the LSB remained concerned that the Charities and Trusts Threshold and the Individual Cap might, if approved, be prejudicial to the Act's regulatory objectives to protect and promote the interests of consumers and protect and promote the public interest.
11. In light of these concerns, the LSB issued a warning notice under paragraph 21(1)(b) of Schedule 4 to the Act in respect of these two proposals. On 25 May 2021, the SRA formally withdrew the proposal for the Individual Cap and submitted further evidence in support of the proposed Charities and Trusts Threshold.

Eligibility: Introduction of the Charities and Trusts Threshold

Overview of issues

12. The SRA proposes to introduce the Charities and Trusts Threshold, to align with the SRA's existing approach to large businesses. Currently, charities with annual income or trusts with assets over £2m are eligible for grant from the Fund if they can show that the associated losses will result in hardship to their beneficiaries.
13. The SRA's rationale is that larger charities and trusts have strong governance, are likely to be regular users of legal services, make sophisticated purchasing decisions, understand the risks involved and put safeguards and controls in place. Moreover, the SRA considers that such charities and trusts are more likely to have the knowledge and resources to actively pursue other avenues of redress to recover missing money, such as litigation. Insurance may also cover the loss and a lay executor of a will leaving a legacy to the charity or trust may still be able to claim from the Fund. The SRA also cites in its application the Charity Commission's guidance on, 'charity reserves: building resilience', which sets out what a charity can do to demonstrate, among other things, the charity's resilience and capacity to manage risks and unforeseen financial difficulties. In the SRA's impact assessment at Annex 4 to its application, it states that, according to the latest figures published by the Charities Register, 86.7% of charities have an annual income under £500,000, 5.6% of charities have an annual income between £500,000 and £5m and 1.3% have an income of more than £5m. The SRA's Board paper at Annex 2i to its application states that past payments from the Fund to larger charities for lost legacies have been up to £146,000.

14. We asked the SRA to provide further evidence in support of their proposal to introduce the Charities and Trusts Threshold, including the levels of historic pay-outs to larger charities and trusts, so that we could understand the real impact on the Fund over time. We also asked the SRA to provide further evidence in support of their approach for using the same threshold of £2m for assets for trusts and annual income for charities.

SRA response

15. In the SRA's reply, it noted that the use of a charity's income and a trust's assets as a measure to inform eligibility was first included in the Fund's Rules in 2014 and it had no evidence to suggest that those measures were wrong or negatively impacted on a charity or trust's ability to make an application to the Fund. The SRA also stated that other comparator schemes² also refer to charities and their annual income or trusts and their assets as a measure of eligibility.
16. The SRA further noted that its approach to charities, trusts and thresholds was consistent with other comparative schemes in the sector, as they also exclude large charities and trusts. For example, the ICAEW's probate scheme and CILEx Regulation's scheme, has a lower threshold of eligibility of £1m income/assets for charities and trusts respectfully.
17. Most of the claims the SRA has historically received from large charities were when they were beneficiaries of an estate and they had not received the legacy or gift. The SRA provided rare examples of prior grants to large charities such as Cancer Research and the National Society for the Prevention of Cruelty to Children (NSPCC), which were for missing legacies and ranged from £126 to £146,000. The SRA informed us that it did not have the data to provide the total amount of historic payments to large charities. However, the SRA assured us that the Charities and Trusts Threshold would still allow more than 90% of charities to make a claim for a grant out of the Fund.

The warning notice

18. We considered that the evidence and justification provided in support of the Charities and Trusts Threshold were insufficient to support approval. Consequently, our warning notice contained a request for the SRA to provide further evidence and/or justification to explain the expected benefits of the Charities and Trusts Threshold and why the SRA proposes to apply the same threshold of £2m to assets and income.
19. In response, the SRA explained that the current eligibility criteria can lead to inconsistent outcomes between large businesses and charities and trusts, and as such, are unfair. Large charities and trusts that could be operating in the same way as large business (or with even greater controls), are currently eligible to apply to the Fund, whereas businesses are not, despite suffering the same loss and hardship. For example, the SRA has in the past made a payment to the NSPCC (which reported that during 2019/20, its total income was £117.6m) but a small business with an income

² ICAEW Probate Compensation Rules uses annual turnover of a registered charity, where CILEx Regulation's compensation arrangements uses net assets value or annual income.

marginally exceeding £2m would not be eligible to claim. The SRA removed hardship tests to focus the Fund on individuals, small businesses and small charities and trusts. The SRA maintains that this represents a clear benefit to the small businesses, charities and trusts that are currently required to demonstrate hardship when applying to the Fund. The proposed removal of the hardship test, is intended to reduce the burden on charities, trusts and businesses when applying for grants. The SRA explained that this may lead to an increase in applicants pursuing an application.

20. The SRA has stated that income is an established way to measure the size of charities and cites the financial reporting requirements under Financial Reporting Standard (FRS) 102, which uses income as the sole measure to establish whether a charity is “a larger charity”. FRS 102 defines a larger charity as one with gross income exceeding £500,000³ which is significantly lower than the SRA’s proposed measures of £2m or above.
21. The SRA has noted that its approach to the Charities and Trusts Threshold recognises that not all large trusts generate income in the way or the same scale as charities. For example, a trust that is made up of significant assets might not be reinvested or sold to generate income and therefore, they are asset-heavy by nature. A large trust could include one where assets such as commercial properties are held for the benefit of its beneficiaries, and do not need to be sold to provide for the beneficiaries. The assets would not be generating income in their original form as property but if sold could yield significant profit which is then distributed to beneficiaries.
22. The SRA considered that the assets of a trust can be easily liquidated compared to assets that may be held by a charity which are subject to more rigorous governance, including oversight from the Charities Commission. The SRA also noted that asset protection trusts are a commonly used tool for concealing wealth/income which would otherwise be subject to tax. The SRA has committed to include a specific element in its evaluation model to assess that these thresholds remain appropriate in light of the introduction of the Charities and Trusts Threshold. The SRA has further stated that it will engage the Charities Commission and publish its evaluation report one, three and five years after implementation of the new CFR.

LSB assessment and conclusion

23. The LSB notes the SRA’s argument that that almost 90% of charities have income falling below the Charities and Trusts Threshold, and that payments to those that may fall outside the Charities and Trusts Threshold have been rare.
24. The LSB further notes the SRA’s explanation of the ability of larger trusts and charities to have access to the expertise necessary to build the resilience to manage the risk and impact of missing money, and that such charities are more likely to have the knowledge and resources to actively pursue other avenues of redress to recover such money.

³ The FRS threshold imposes a burden of higher levels of reporting standards such as the provision of cashflow statements and additional disclosures in trustee reports.

Overall, we consider that this significantly reduces the risk of potential detriment to the beneficiaries of larger charities and trusts.

25. On balance, we further consider that any potential risk of detriment to larger charities and trusts is outweighed by the need for the CFR to provide consistent and fair outcomes which prioritises those that are most in need. On this basis we are satisfied that the removal of the hardship test for eligibility will reduce the burden on those who fall within the Charities and Trusts Threshold and that the £2m cap on assets and annual income is appropriate, provided it is regularly reviewed as indicated at paragraph 22 above.
26. The LSB does not therefore consider that this proposal is likely prejudicial to the regulatory objectives or engages the refusal criteria. For the same reasons we are also satisfied with the SRA's reasons for applying the same threshold of £2m or above to assets and income.

Prioritisation: New expectations concerning applicant behavior and how this is taken into account when deciding whether to make a payment from the Fund.

27. The current rules provide that the SRA may reduce or refuse a grant when an applicant's own actions contribute to, or they fail to take actions that could have prevented or mitigated the loss that they suffered. This may either be at the time they are engaging in the activity that leads to financial loss, or while applying for a payment from the Fund.
28. The changes to the CFR introduce an explicit statement that a grant may be reduced or refused if there has been any dishonest, improper or unreasonable conduct by the applicant during the course of the circumstances that gave rise to the loss, and when requesting a payment from the Fund. The SRA will also refuse or reduce a payment where the applicant has failed to pursue the application promptly, co-operatively and in good faith. To help clarify the circumstances when the conduct of an applicant may warrant refusal or reduction to a payment, the SRA will publish information on its website.
29. We were concerned that the SRA's consideration of conduct and whether the pursuit of an application was prompt may discriminate against vulnerable applicants. We asked the SRA to provide the LSB with copies of the online resources that are intended to assist applicants to understand how conduct will be considered, and whether the SRA would be providing additional support.

SRA response

30. The SRA stated that it would look at the facts of each case and the circumstances of the applicant. It will provide case study examples to help consumers understand the types of behaviours that might lead to a refusal or reduction to a grant from the Fund. Annex 2 to the application provides some examples. The SRA has said that these case studies will be tested with consumers as part of the monitoring and evaluation proposals described at paragraph 22 above.

31. The SRA has stated that it has rewritten the guidance on simplification of the application form and developed supporting notes on how to complete the form.
32. The SRA has used testers (individual professionals working for organisations that support vulnerable individuals and have experience of helping individuals to complete forms) to assess how easy it is for users to find and complete the application form. The feedback and suggestions that have been provided are now being used by the SRA to help draft the next iterations of the landing page and application form. There will be further testing of the online content and processes to provide other support to applicants before the changes to the revised CFR are implemented.
33. Further, the SRA has said it will be making key documents available in various languages. It will also provide translation services on a case-by-case basis if requested by an applicant. As part of the testing, the SRA has used the 'system usability score', which is used to evaluate a wide variety of products and services. The scores for the SRA's landing page and application form were high and put them in the 'excellent' usability range. The SRA will collaborate with organisations such as Citizen's Advice, Age UK, Law Centres Network, and other organisations that people may turn to for help to review content. Making sure the Fund remains accessible to vulnerable consumers will be a key focus of the SRA's monitoring and evaluation of the reforms.

LSB assessment and conclusion

34. We are satisfied that the SRA will provide sufficient material to support applicants to enable them to successfully complete the application process and have an understanding of the behaviours which would influence the level of grant awarded from the Fund. The LSB's regulatory performance framework will also provide an opportunity for the LSB to assess the SRA's ongoing work to ensure that the Fund remains accessible.

Costs: Removal of grants for costs associated with making an application to the Fund.

35. The SRA proposes to no longer provide financial support for those that seek professional support towards making applications. The SRA has stated that, historically, most claimants do not instruct professional support, but it acknowledges that this may impact vulnerable consumers (including those with disabilities and those who do not have English as their first language). The SRA has stated that it will improve support to applicants during the application process, to include:
 - reviewing SRA online guidance to ensure it clearly sets out who is able to claim, the type of claim that will be considered, the information the SRA will need, how to complete the application form and top tips for common issues;
 - simplifying the application form and process and providing the necessary assistance to applicants as they fill out the form;
 - developing new guidance and training for staff around supporting the applicant through the process and advising them of the information required;

- updating guidance and training to ensure that the SRA's teams have the appropriate tools to assist; This may include, for example, assisting applicants with disabilities by making reasonable adjustments where needed; and
 - continuing to research alongside charities and other organisations the resources and assistance that people may turn to for advice when they suffer a loss.
36. We sought clarification as to the timing of the commencement of the support, so that we could be assured it would coincide with the implementation of the proposed CFR.
37. The SRA has confirmed that it will put the support in place prior to the publication of the CFR (if approved by the LSB). The SRA noted that most of those who currently apply to the Fund do not use a solicitor or professional adviser to assist them. The SRA already has a skilled team that offers support and assistance to applicants.

LSB assessment and conclusion

38. We are satisfied that the SRA will provide material and support to applicants (particularly vulnerable consumers) to successfully complete the application process, which the LSB will be able to assess as part of its performance assessment procedures. We therefore do not consider that this proposal engages the refusal criteria.

Prioritisation: Circumstances where SRA will make payments where insurance is not in place

39. The SRA's application states that no payments will be available under the new CFR in the event of insurer insolvency (i.e., where run-off policies have been disclaimed by a liquidator as part of the liquidation process). This is because this is not a loss caused by the default of a solicitor or firm and the Fund should not be available for any financial loss suffered by a consumer of legal services from a solicitor.
40. The SRA explained that law firms that have paid premiums and persons that have a claim against that firm, may be able to seek redress from the Financial Services Compensation Scheme (FSCS). If law firms (or their consumers) are not eligible to make a claim against the FSCS or against the insolvent insurer, then the SRA would expect, for example, larger firms to be in a position to provide redress themselves or agree a settlement with the person asserting the claim.
41. We asked the SRA to provide assurances that alternative suitable redress will be available to consumers and small firms, where such firms are unable to make a settlement or provide redress, before the new CFR are implemented.

SRA response

42. The SRA said that in the case of an insolvent insurer, the availability of redress will depend upon the steps being taken by the appointed administrator and how they are managing the winding up of the insurer's exposure. If policies are not cancelled by the administrator, then the SRA would expect a consumer to be able to make a claim against the policy, subject to any legal limitations. If the policy is cancelled by the administrator, then impacted firms and individuals will be advised if they can apply to the FSCS, which would consider the claim against their schemes rules.

43. The SRA stated that it is aware that the Fund has received a very small number of applications for a grant in the circumstances where a run-off insurance policy had been cancelled by the administrator, or similar. The SRA considers that these very low volumes suggest that the Fund is not generally considered to be the appropriate route for these claims. The SRA has said that if it does receive claims, it will continue to help applicants understand their alternative routes for redress.

LSB assessment and conclusion

44. The LSB considers it appropriate for redress to be provided through the insolvency process and the redress scheme set up by the insurer's regulators. The LSB further notes and is satisfied with the SRA's commitment to continue to support applicants to understand alternative routes for redress.

Payments: Application of a fixed £5m cap to multiple applications from single or connected events.

45. The SRA proposes to cap payments for multiple high value claims arising from a single or connected event at £5m. The SRA has said the cap will allow it to manage the potential liability to the Fund from high value connected applications arising out of, for example, dubious investment schemes or an intervention into a large solicitors' practice.
46. The SRA has also warned solicitors and law firms about the risks of being involved in high-risk investments and it expects that the recent cases that have been considered by the Solicitors Disciplinary Tribunal (SDT) will act as a deterrent.
47. The SRA has stated that the proposed cap of £5m is important to ensure that the Fund remains viable and will make it easier for the SRA to maintain more consistent levels of contributions from solicitors and firms each year. The approach would also allow all eligible applicants to still receive a reasonable level of redress that compares favourably to other schemes with capping mechanisms. As outlined in the SRA's supporting evidence and analysis at Annex 3 to its application, several other compensation schemes apply mechanisms that aim to cap the liability for very large losses.
48. We asked the SRA to provide further evidence that £5m is a suitable cap.

SRA's response

49. The SRA stated that it had reviewed a number of options, including more flexible approaches with greater discretion to set the level of the cap on a case-by case basis. On balance, the SRA decided that a fixed cap would provide transparency and certainty for the public, the profession and the Fund. The SRA explained that its approach does provide flexibility to apply any of a number of options for apportioning the £5m between applicants depending on the nature of the issue. This allows the SRA to make sure that payments are apportioned fairly in different circumstances.
50. In deciding on a £5m cap, the SRA reviewed confidential data about the high value, connected claims that were being considered at the time of consultation for its proposed

reform to the CFR. The SRA's estimate of the value of claims arising for each ranged from £1m to £10m with an average of £5m. There were a small number of connected events that may have totalled more than £5m. The SRA provided the LSB with confidential data on the total grants paid out each year to date, and the grants currently expected to be paid in the future.

51. The SRA decided that the £5m threshold was a proportionate sum considering the liability being faced by the Fund and the potential impact on contribution levels if connected claims were to be paid in full. The SRA has committed to periodically review the £5m figure based on the changing profile of claims and the analysis of the impact it will have in practice.
52. The SRA said that in August 2020 it published a thematic report on high-risk investment schemes, highlighting unacceptable behaviours and updating the SRA warning notice to make it clear, among other issues, that solicitors must be vigilant if they are asked to conduct certain activities concerning dubious or risky investment schemes which may be misrepresented as routine conveyancing or investment in land. The SRA has also taken enforcement action in the last five years, culminating in the SDT striking off 16 solicitors, suspending eight, and imposing fines totalling £870,000. The SRA has also previously issued guidance and published three warning notices about the key signs of dubious investments in 2013, 2016 and 2017.
53. The SRA has confirmed that the changes do not impact other regulators' schemes, and it will continue to signpost to other schemes of redress where appropriate.

LSB assessment and conclusion

54. We consider that the SRA's approach appears to be proportionate and driven by the analysis of historic grants and an estimation of the significant impact on contributions to the Fund. We also note the SRA's work to reduce the likelihood of solicitors' participating in these schemes and the actions the SRA has taken against those who have. This should reduce these types of losses arising in the future. On balance, we consider that any potential detriment to the minority of consumers who make connected applications for a grant from the Fund is outweighed by the benefit of ensuring the Fund remains viable for all who most need it. Therefore, we do not consider that this proposal raises grounds to refuse the application.

Costs: Exclusion of grants for litigation costs other than in exceptional circumstances.

55. The SRA proposed to no longer prioritise grants from the Fund to cover litigation costs if it has decided that the applicant has the means and resources to pursue litigation. The SRA has explained that this is to prioritise payments that provide redress for direct financial losses and to protect against the risk of being tied to paying for escalating litigation costs.
56. The SRA states that it may pay some litigation costs in exceptional circumstances and will publish further guidance to clarify this.

57. We asked the SRA to provide:

- the guidance that is intended to shape the exceptional circumstances;
- details as to payments made under this heading to date;
- details of payments made for litigation costs over the last 5 years to ascertain the historical impacts on the Fund; and
- any data to support increased pressure due to Covid-19.

SRA response

58. The SRA explained its approach to claims for litigation costs:

- The SRA will determine whether the applicant is able to pursue other avenues of redress. The SRA would expect well organised, resourced and/or sufficiently informed applicants to take more steps than a vulnerable person making an application on their own behalf.
- Where the SRA decides that an applicant should and is able to pursue litigation, that applicant would need to finance these costs themselves. The SRA notes that the litigation process allows for an application for costs to be made in addition to the claim for substantive losses. If professional advisers are engaged to help with the litigation, then there are also other funding mechanisms, such as contingency fee agreements, that could be considered.

59. The SRA said that, in practice it is rare to require applicants to consider legal action to recover their loss before making a claim from the Fund. Given the costs of such action, the SRA will only do so where it would be proportionate and reasonable in relation to the sum lost. For that reason, payments for litigation costs are infrequent. The SRA has said that it might pay costs upfront where (i) claims are for very high amounts (ii) the SRA thinks that the pursuit of another remedy is likely to be successful and (iii) the applicant does not otherwise have the financial resources to pursue them. The SRA also provided draft illustrative case studies which it intends to publish once finalised.

LSB assessment and conclusion

60. We consider that the SRA's approach is reasonable and does not engage the refusal criteria in paragraph 25(3) of Schedule 4 to the Act.

Decision

61. The LSB has considered the SRA's application against the criteria in paragraph 25(3) of Schedule 4 to the Act. It accordingly grants the application in full.

62. Annex **A** to this decision notice contains the amended regulatory arrangements that are approved by the LSB.

Matthew Hill, Chief Executive
Acting under delegated authority granted by the Legal Services Board
14 June 2021

Notes:

1. The LSB is required by Part 3 of Schedule 4 to the Act to review and grant or refuse applications by approved regulators to make alterations to their regulatory arrangements.
2. Paragraph 25(3) of Schedule 4 to the Act explains that the LSB may refuse an application setting out a proposed change to the regulatory arrangements only if it is satisfied that
 - (a) granting the application would be prejudicial to the regulatory objectives
 - (b) granting the application would be contrary to any provision made by or by virtue of this Act or any other enactment or would result in any of the designation requirements ceasing to be satisfied in relation to the approved regulator
 - (c) granting the application would be contrary to the public interest
 - (d) the alteration would enable the approved regulator to authorise persons to carry on activities which are reserved legal activities in relation to which it is not a relevant approved regulator
 - (e) the alteration would enable the approved regulator to license persons under Part 5 [of the Act] to carry on activities which are reserved legal activities in relation to which it is not a licensing authority, or
 - (f) the alteration has been or is likely to be made otherwise than in accordance with the procedures (whether statutory or otherwise) which apply in relation to the making of the alteration.
3. The designation requirements referred to in paragraph 2(b) above are set out in paragraph 25(4) of Schedule 4 to the Act and are
 - (a) a requirement that the approved regulator has appropriate internal governance arrangements in place
 - (b) a requirement that the applicant is competent, and has sufficient resources to perform the role of approved regulator in relation to the reserved legal activities in respect of which it is designated, and
 - (c) the requirements set out in paragraphs 13(2)(c) to (e) of Schedule 4, namely that the regulatory arrangements are appropriate, comply with the requirements in respect of resolution of regulatory conflict (imposed by sections 52 and 54 of the Act) and comply with the requirements in relation to the handling of complaints (imposed by sections 112 and 145 of the Act).
4. In accordance with paragraphs 20(1) and 23(3) of Schedule 4 to the Act, the LSB has made rules⁴ about the manner and form in which applications to alter regulatory arrangements must be made. Amongst other things, the rules highlight the applicant's obligations under section 28 of the Act to have regard to the Better Regulation Principles. They also require applicants to provide information about each proposed change and details of the consultation undertaken.
5. If the LSB is not satisfied that one or more of the criteria for refusal are met, then it must approve the application in whole, or the parts of it that can be approved.

⁴ Rules for Rule Change Applications – Version 2, April 2018
[https://www.legalservicesboard.org.uk/what_we_do/regulation/pdf/New%20folder%20\(2\)/FINAL_Rules_for_applications_to_alter_regulatory_arrangements.pdf](https://www.legalservicesboard.org.uk/what_we_do/regulation/pdf/New%20folder%20(2)/FINAL_Rules_for_applications_to_alter_regulatory_arrangements.pdf)

Annex A

SRA Compensation Fund Rules 2021

Introduction

These rules govern the way that we operate the SRA Compensation Fund.

It is funded by contributions from individuals and firms authorised by us.

We have developed a statement setting out the purpose of the fund [link to statement] and guidance on the way we operate the fund [link to guidance].

Part 1: The Fund

Maintenance of and contributions to the Fund

- 1.1 The *SRA* shall establish and maintain a fund for making grants in respect of applications made in accordance with these rules.
- 1.2 *Solicitors, RELs, RFLs, recognised bodies* and *licensed bodies* must make contributions to the *Fund* in such amounts and at such times as may be *prescribed*.
- 1.3 Any unpaid contributions may be recovered as a debt due to the *SRA*.
- 1.4 The *SRA* may at any time:
 - (a) borrow for the purposes of the *Fund*;
 - (b) charge investments which form part of the *Fund* as security for borrowing by the *SRA* for the purposes of the *Fund*.

Residual discretion and fund of last resort

- 2.1 The *Fund* is a discretionary fund of last resort and no *person* has a right to a grant enforceable at law. The *SRA* retains a discretion to refuse to consider an application or to make a grant notwithstanding that the conditions in these rules for making a grant are satisfied.
- 2.2 The circumstances in which the residual discretion in rule 2.1 may be exercised include, but are not limited to, circumstances in which the *SRA* considers that the loss suffered is not material in all the circumstances or has been appropriately compensated through another means.
- 2.3 The *SRA* may refuse or reduce a grant where the loss or part of the loss is, or was, capable of being made good or appropriately compensated by some other means, including another compensation scheme.

Part 2: Payment of grants from the Fund

Grants which may be made from the Fund

- 3.1 A *person* may apply for a grant out of the *Fund* if the loss referred to in rule 3.3 relates to services provided:
- (a) by the *defaulting practitioner* for them; or
 - (b) to, or as, a *trustee* where they are a beneficiary of the estate or trust.
- 3.2 A *person* who is not a client of the *defaulting practitioner* may apply for a grant out of the *Fund* if they:
- (a) were a party on the other side of a legal matter on which the *defaulting practitioner* was acting; and
 - (b) have suffered, or are likely to suffer, financial loss in accordance with rule 3.3 arising as a result of the *defaulting practitioner* failing to apply funds for the purpose intended where they should have been used (whether on completion of certain conditions or otherwise) to complete a transaction for their benefit, or to make a settlement or other payment to them.
- 3.3 For any grant to be made out of the *Fund*, an *applicant* must satisfy the *SRA* that the *applicant* is eligible in accordance with rule 4 and (save in respect of a grant made under rule 3.4) has suffered, or is likely to suffer, financial loss directly resulting from:
- (a) the dishonesty of a *defaulting practitioner* or the employee or *manager* or *owner* of a *defaulting practitioner*; or
 - (b) failure to account for money which has come into the hands of a *defaulting practitioner* or the employee or *manager* or *owner* of a *defaulting practitioner*, which may include the failure by a *defaulting practitioner* to complete work for which the *defaulting practitioner* was paid,

in the course of an activity of a kind which is part of the usual business of a *defaulting practitioner* and, in the case of a *defaulting licensed body*, the act or default arose in the course of performance of an activity regulated by the *SRA* in accordance with the terms of the body's licence.

- 3.4 The *SRA* may make a grant to alleviate direct losses suffered as a result of the civil liability of a *defaulting practitioner* or a *defaulting practitioner's employee, manager* or *owner* in circumstances where:
- (a) the *defaulting practitioner* in accordance with the *SRA Indemnity Insurance Rules* should have had, but did not have, in place a *policy* of *qualifying insurance*;
 - (b) the liability of the *defaulting practitioner* or the *defaulting practitioner's employee* or *manager* would have been covered by a *policy* of *qualifying insurance*; and
 - (c) the loss is not covered by the *SIF*.
- 3.5 No grant will be made under rule 3.4 where due to the insolvency or cessation of the *insurer* the *defaulting practitioner's policy* of *qualifying insurance* has been disclaimed or otherwise ceases.
- 3.6 The *SRA* may make a grant as an interim measure in relation to part of an application before the application has been fully assessed.

Eligibility for a grant

- 4.1 A *person* is eligible to apply for a grant out of the *Fund* if, at the time the application is made, they are:
- (a) an individual;
 - (b) a sole trader, *partnership, body corporate*, unincorporated association or mutual association with an annual *turnover* or *assets* of less than £2 million;
 - (c) a *charity* with annual income net of tax in the most recent financial year of less than £2 million; or
 - (d) a *trustee* of a trust with an asset value of less than £2 million.
- 4.2 The *SRA* may take into account such evidence as it sees fit when determining eligibility under rule 4.1 and may make a broad estimate of any relevant amount.

Defaulting practitioners

- 5.1 A *defaulting practitioner* means:
- (a) a *solicitor* or an *REL* who at the date of the relevant act or omission was:
 - (i) practising in an *authorised body*; or
 - (ii) practising in a *non-commercial body*;
 - (b) a *solicitor* or an *REL* who at the date of the relevant act or omission:

- (i) was self-employed and practising in their own name, and not through a trading name or service company;
 - (ii) did not employ anyone in connection with the services they provided; and
 - (iii) was engaged directly by their clients with their fees payable directly to them;
- (c) an *RFL* who is a manager or owner of an authorised body;
 - (d) a *recognised body*; or
 - (e) a *licensed body*,

and the expressions "defaulting solicitor", "defaulting REL", "defaulting recognised body", "defaulting RFL" and "defaulting licensed body" shall be construed accordingly.

5.2 A grant may be made where, at the date of the relevant act or omission:

- (a) the *defaulting solicitor* had no practising certificate in force;
- (b) the registration of the *defaulting REL* or *defaulting RFL* had expired or been revoked;
- (c) the authorisation of the *defaulting recognised body* or *defaulting licensed body* had been suspended or revoked;

provided that the *SRA* is satisfied that the *applicant* was unaware of the absence of a valid practising certificate or the relevant expiry, suspension or revocation (as the case may be).

Grants to defaulting practitioners

6.1 The *SRA* may make a grant to a *defaulting practitioner* who or which has suffered or is likely to suffer loss by reason of their liability to any client resulting from an act or omission of:

- (a) in the case of a *defaulting solicitor*, *defaulting REL* or *defaulting RFL*, any of their *employees* or any fellow *manager*;
- (b) in the case of a *defaulting recognised body*, any of its *employees or managers or owners*;
- (c) in the case of a *defaulting licensed body*, any of its *employees or managers or owners*, provided that such act or omission arose in the course of performance of an *activity* regulated by the *SRA* in accordance with the terms of the body's licence,

in circumstances where, but for the liability of the *defaulting practitioner*, a grant might have been made from the *Fund*

- 6.2 The *SRA* may make a grant under this rule by way of a loan upon such terms as the *SRA* specifies.
- 6.3 In the case of a *defaulting recognised body* or a *defaulting licensed body*, the *SRA* may make such grant payable to one or more of the *managers* or *owners* of the *defaulting recognised body* or *defaulting licensed body*. If a loan is made to more than one *person*, they shall be jointly and severally liable for the repayment of the loan.

Grants in respect of statutory trusts

- 7.1 The *SRA* may make a grant to alleviate a deficiency in a *statutory trust* held by the *SRA*.
- 7.2 The *SRA* may make a grant to a *person* where the money would have been due to that *person* but for their claim having been extinguished under rule 9.2 of the SRA Intervention Powers (Statutory Trust) Rules 2011 or rule 8.2 of the SRA Statutory Trust Rules.

Interest

- 8.1 In respect of any grants made under rules 3, 6 or 7 the *SRA* may make a supplementary grant by way of a sum in lieu of lost interest on the loss underlying the principal grant. Such interest will be calculated by the *SRA* in accordance with *prescribed* rates.
- 8.2 Where the application for the principal grant is in respect of a failure to redeem a mortgage, the *SRA* may also make a grant in respect of the additional interest accrued to the mortgage account as a result of the *defaulting practitioner's* failure to redeem.

Maximum grant

- 9.1 Unless the *SRA* is satisfied that there are exceptional circumstances in the public interest that justify a higher sum, the maximum grant that may be made for a single claim is £2 million.
- 9.2 For the purposes of this rule, a single claim is an application, or applications, from an *applicant* for the loss incurred by them arising from a single event or set of connected underlying circumstances.

Capping payments of multiple applications

- 10.1 Where multiple applications are made to the *Fund*:
 - (a) that relate to the same or connected underlying circumstances; and

- (b) the *SRA* is satisfied that the total amount of the grants made from the *Fund* in respect of such applications is likely to exceed £5 million,

the *SRA* may impose a limit on the total amount to be paid in respect of those applications of £5 million.

10.2 Where the *SRA* imposes a limit under rule 10.1, the amount paid may be apportioned between the *applicants* to whom the *SRA* is satisfied a grant is payable, in such of the following ways as the *SRA* considers appropriate in the circumstances:

- (a) the amount to be apportioned equally between all those who have made an application within such reasonable time period for the purpose as shall be published by the *SRA*; or
- (b) such percentage of loss or amount to be paid, as the *SRA* considers appropriate in all the circumstances.

Conduct of the applicant and contribution to loss

11.1 A grant may be refused or reduced to take account of:

- (m) dishonest, improper or unreasonable conduct by the *applicant* or anyone acting on their behalf:
 - (i) in the circumstances that gave rise to the application;
 - (ii)** in relation to the application itself; or
- (n) failure to pursue the application promptly, co-operatively and in good faith.

11.2 A grant may be refused or reduced to take account of any act or omission by the *applicant* or anyone acting on their behalf that has contributed to or has failed to mitigate the loss.

Losses outside the remit of the Fund

12.1 For the avoidance of doubt, the *SRA* shall not make a grant in respect of losses that:

- (a) arise solely by reason of professional negligence by a *defaulting practitioner*, or the *employee* or *manager* of a *defaulting practitioner*, save as provided for in rule 3.4;
- (b) are indirect or consequential, save where the *SRA* exercises its discretion to make a grant:
 - (i) under rule 8;
 - (ii) for costs of completing or remedying work for which the *defaulting practitioner* has been paid; or

- (iii) for loss where a client of a *defaulting practitioner* has been made personally liable for loss suffered by a third party as a result of the act or omission of that *defaulting practitioner*.
- (o) are, or result from, the trading debts or liabilities of the *defaulting practitioner*, including claims for fees payable to the *applicant* for which the *defaulting practitioner* is liable;
- (p) comprise legal or other professional costs incurred by the *applicant* in making an application to the *Fund*;
- (q) are for costs of proceedings instituted by the *applicant* for recovery of their loss, save in exceptional circumstances;
- (f) are for interest payable to the *applicant*, save where the *SRA* exercises its discretion to make a grant under rule 8;
- (g) are suffered by the Legal Aid Agency as a result of making regular payments under the Agency's contracting schemes for civil or criminal work; or
- (h) are in circumstances where the *applicant*:
 - (i) has been made bankrupt and any grant would vest in the trustee in bankruptcy;
 - (ii) has entered into a voluntary arrangement with their creditors and any grant would vest in the administrator of the arrangement; or
 - (iii) is in liquidation.

Foreign lawyers

- 13.1 The *SRA* shall not make a grant in respect of any act or omission of an *REL*, or the *employee* of an *REL*, where such act or omission took place outside the *UK*, unless the *SRA* is satisfied that the act or omission was, or was closely connected with, the act or omission of a *solicitor* or the *employee* of a *solicitor*, or that the act or omission was closely connected with the *REL's* practice in the *UK*.
- 13.2 The *SRA* shall not make a grant in respect of the act or omission of an *RFL*, or the *employee* of an *RFL*, where such act or omission took place outside England and Wales, unless the *SRA* is satisfied that the act or omission was, or was closely connected with, the act or omission of a *solicitor* or the *employee* of a *solicitor*, or that the act or omission was closely connected with *practice* in England and Wales.

Apportionment and multi-party issues

- 14.1 Where the loss has been sustained as a result of the act or omission of more than one party, the *SRA* will consider the role of each party in contributing to the

applicant's loss in deciding whether to make a grant and, if so, the amount of any grant.

- 14.2 In the case of a *defaulting licensed body*, the *SRA* will consider the extent to which the loss is attributable to an act or omission which falls outside the performance of *an activity regulated by the SRA* in accordance with the terms of the body's licence in deciding whether to make a grant and, if so, the amount of any grant.

Part 3: Applications and procedures

Application and time limit

- 15.1 An *applicant* must make an application for a grant in the *prescribed* form, and within 12 months of the date they first became aware, or should reasonably have become aware, of the loss.
- 15.2 The *SRA* may extend the 12 month period in rule 15.1 if satisfied that there are circumstances which justify the extension of the time limit.
- 15.3 The *applicant* must provide any information, documents and evidence requested by the *SRA*, which may include verification of matters by statement of truth or affidavit. Failure to provide such documentation or to co-operate with the *SRA* will be taken into account when determining the merits of the application.

Notice to defaulting practitioner

- 16.1 The *SRA* may not make a grant unless it has given not less than 8 days' notice to the *defaulting practitioner* informing them of the nature and value of the application, unless it appears to the *SRA* that it would not be reasonably practicable to give such notice, or the grant should be made urgently.
- 16.2 Where the *SRA* has made a grant urgently in accordance with rule 16.1, the *SRA* shall as soon as, and so long as, it is practicable to do so, give notice to the *defaulting practitioner* in the terms set out in rule 16.1 and may (insofar as any failure to give notice before the making of the grant has prejudiced the *defaulting practitioner*) waive in whole or in part the *Fund's* right of recovery under rule 17 against the *defaulting practitioner*.

Recovery and subrogation

- 17.1 Where the *SRA* makes a grant otherwise than by way of loan or if by way of loan repayments of the loan is waived or otherwise the borrower has failed to repay part or all of the loan, the *SRA* shall be subrogated to the rights and remedies of the *person* to whom or on whose behalf the grant is made to the extent of the amount of the grant.

- 17.2 Where rule 17.1 applies, the recipient must if required by the *SRA* whether before or after the grant has been made and upon the *SRA* giving the recipient a sufficient indemnity against costs, prove in any insolvency or winding up of the *defaulting practitioner* and sue for recovery of the loss in the name of the recipient but on behalf of the *SRA*.
- 17.3 The recipient of a grant must comply with all proper and reasonable requirements of the *SRA* for the purpose of giving effect to the *SRA's* rights under this rule, and shall permit the *SRA* to have conduct of any proceedings brought on its behalf.

Refusal of an application

- 18.1 If the *SRA* refuses to make a grant of either the whole or part of the amount applied for, the *applicant* will be informed in writing of the reasons for the decision.
- 18.2 The fact that an application has been rejected does not prevent a further application being submitted provided that material, new and relevant evidence or information is produced in support of the new application.

Supplemental notes

Made by the SRA Board on 14 July 2020.

Made under sections 36 and 36A of the Solicitors Act 1974, section 9 of, and paragraph 6 of Schedule 2 to, the Administration of Justice Act 1985, section 83 of, and paragraph 19 of Schedule 11 to, the Legal Services Act 2007 and the Legal Services Act 2007 (The Law Society and The Council of Licensed Conveyancers) (Modification of Functions) Order 2011.