

**SRA Board
17 September 2014**

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SRA Compensation Fund - introduction of eligibility criteria

Purpose

- 1 The purpose of this paper is to ask the SRA Board to consider and make the SRA Amendments to Regulatory Arrangements (Compensation Fund Eligibility) Rules [2014] which have been prepared to implement eligibility criteria for claims made to the SRA Compensation Fund.

Recommendation

- 2 The Board is invited to make the SRA Amendments to Regulatory Arrangements (Compensation Fund Eligibility) Rules [2014], subject to the approval of the Legal Services Board (LSB) (**Annex 1**).

If you have any questions about this paper please contact: Crispin Passmore, Executive Director, crispin.passmore@sra.org.uk; 0121 329 6687

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SRA Compensation Fund - introduction of eligibility criteria

Background

- 1 In May 2014, we published a [consultation paper](#) proposing the introduction of eligibility criteria for making a claim on the SRA's Compensation Fund.
- 2 On 2 July 2014, the Board was provided with a summary of responses to the consultation and the SRA's proposed response. The Board also had the opportunity to consider a regulatory impact assessment which set out an assessment of the proposed change against the regulatory objectives, and also in light of our public sector equality duty and the better regulation principles.
- 3 The Board agreed in principle to the implementation of eligibility criteria and approved the publication of the SRA's response to the consultation. The Board noted that the rules required to implement the change would be presented at a later date. If approved by the Board, and subject to LSB approval, the rules will come into effect on 1 April 2015 and the criteria will apply to all claims received from that date. Prior to 1 April 2015, details of criteria will be communicated and set out on the SRA website so that stakeholders are aware of the criteria and its impact.

The proposed criteria and rule amendments

- 4 The consultation set out proposed eligibility criteria, limiting applications to the SRA's Compensation Fund to:
 - individuals;
 - micro-enterprises – businesses with a turnover not exceeding £2 million;
 - charities with annual income of less than £2 million; and
 - trustees of a trust with a net asset value less than £2 million.

An amendment to the SRA Handbook glossary definition of '*Applicant*' was proposed, to give effect to the criteria.

- 5 Taking into account feedback from the consultation exercise, we consider it appropriate for the criteria to be set out in within the body of the SRA Compensation Fund Rules 2011, so that potential applicants can access and understand the requirements. It is therefore, proposed that the new criteria are set out within the body of the SRA Compensation Fund Rules 2011. The draft rules are annexed at Annex 1.
- 6 We have taken the opportunity to simplify the criteria where possible and set out who will be eligible to apply for a grant out of the Fund. We have also confirmed that the criteria will apply at the time an applicant makes a claim to the Fund and that we will have the discretion to adopt a method to determine

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eligibility and to make a broad estimate of any relevant amount. This is intended to avoid technical or disproportionate arguments about the eligibility requirements and will allow the SRA to determine and make an estimate of the financial amounts in relation to eligibility of applicants. We consider this to be an appropriate approach given the nature of the Fund and have noted that a similar approach was adopted in determining [eligibility to make a complaint](#) to the Legal Ombudsman. This rule amendment is set out in the draft Rule 3.11 of Annex 1.

- 7 We have introduced a definition of turnover in the SRA Handbook Glossary 2012 with reference to terminology used in Companies Act 2006. 'Turnover' has been defined the amounts derived from the provision of goods and services in the most recent financial year, after deduction of:
- (a) trade discounts,
 - (b) value added tax, and
 - (c) any other taxes based on the amounts so derived.

This definition has been drafted with reference to section 474(1) of the Companies Act 2006 as this definition is understood to be used for accounting purposes.

Charities and trusts

- 8 At its meeting on 2 July 2014, the Board discussed whether charities and trusts should continue to be eligible to make a claim and whether this was compatible with the objectives of the fund.
- 9 The Standards Committee has since considered this issue further. It agreed that permitting charities to continue to be eligible to make claims would be consistent with the objective of the proposed criteria, which is to limit protection to individuals or small organisations. It noted that many of the beneficiaries of charities are individuals who may suffer hardship if a payment is not made to replace money that a defaulting practitioner has misappropriated or failed to account for. Standards Committee also agreed that there was a similar argument to be made in respect of trusts. While a trust might have a high aggregate value, individual beneficiaries may be of modest means.
- 10 However, the Standards Committee decided that it was appropriate that the 'hardship test' was applied more widely to charities and trusts with an income or net asset value of more than £2 million, than to other claimants, that is by applying the test to all claims, including dishonesty. This has been set out in the new Rules 3.9 and 3.10 of Annex 1.

Decision making criteria

- 11 Decision making criteria currently apply to all decisions taken in respect of making grants from the Fund. Most claims received are investigated and

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referred to an Authorised Officer, Adjudicator or Panel of Adjudicators for a formal decision. This includes matters where it is recommended that the application is refused for example because the applicant has contributed to his or her loss. It is proposed as part of the rule changes required to implement the eligibility criteria that a rule is made confirming that applications which fall outside the remit of the Fund will be determined summarily. It is envisaged that this will save time, cost and resource in the investigation of an application. Rule 3.12 has therefore, been included to reflect this position.

Next steps

- 12 Subject to the decision of the Board, an application will be made to the LSB asking that they approve changes to our regulatory arrangements. The Law Society is aware of the proposal to introduce eligibility criteria and will be informed of the Board's decision.
- 13 Guidance for applicants is being finalised which will be made available on the SRA website, Legal Choices and circulated to consumer groups and forums. The guidance will enable potential applicants to decide whether they are eligible to make a claim and the information that they may be required to provide when submitting a claim. In addition a communications package will be put into effect to support implementation prior to 1 April 2015 and to further engage on the review of the SRA's compensation arrangements.

Impact assessment

- 14 The impact of the decision to introduce eligibility criteria has been considered and set out in the paper which was presented to the Board on 2 July 2014. No further risks or impacts have been identified which require consideration. A table setting out the eligibility criteria and relevant rules has been prepared and is attached at Annex 2.

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Annexes

Annex 1 Draft SRA Amendments to Regulatory Arrangements
(Compensation Fund Eligibility) Rules [2014]

Annex 2 Table of proposed eligibility

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Draft SRA Amendments to Regulatory Arrangements (Compensation Fund Eligibility) Rules [2014]

Preamble

Rules dated [date of approval by LSB] made by the Solicitors Regulation Authority Board under sections 36, 36A, 79 and 80 of the Solicitors Act 1974, section 9 of the Administration of Justice Act 1985, section 83(5)(e) of, and paragraph 19 of Schedule 11 to, the Legal Services Act 2007, and the relevant provisions of an Order made under section 69 of the Legal Services Act 2007, SI No 2011/1716, with the approval of the Legal Services Board under paragraph 19 of Schedule 4 to the Legal Services Act 2007.

Rule 1

The SRA Compensation Fund Rules 2011 shall be amended as follows:

(a) replace rule 3.4 with:

“3.4 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 3.7, 3.8, 3.9 or 3.10 and (save in respect of a grant made under rule 5) that:

(a) he has suffered or is likely to suffer loss in consequence of the dishonesty of a *defaulting practitioner* or the *employee* or *manager* or *owner* of a *defaulting practitioner*, or

(b) he has suffered or is likely to suffer loss and hardship in consequence of a 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 he 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 a *regulated activity*.”

(b) insert rules 3.7 to 3.12 as follows:

“3.7 A *person* is eligible under this rule to apply for a grant out of the Fund where the *person*:

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(a) is an individual; or

(b) at the time the application is made, is a sole trader, *partnership*, *body corporate*, unincorporated association or mutual association with an annual *turnover* of less than £2 million;

and does not fall within rule 3.8, 3.9(a) or 3.10(a).

3.8 A *person* is eligible under this rule to apply for a grant in the circumstances set out in rule 3.4(a) if at the time the application is made the *person* falls within one or more of the following categories:

- (a) a *charity* with annual income net of tax in the most recent financial year of less than £2 million; or
- (b) a *trustee* of a trust with an asset value of less than £2 million.

3.9 A *person* is eligible under this rule to apply for a grant in the circumstances set out in rule 3.4(b) if the *person*:

- (a) at the time the application is made falls within one or more of the following categories:
 - (i) a *charity* with annual income net of tax in the most recent financial year of less than £2 million; or
 - (ii) a *trustee* of a trust with an asset value of less than £2 million;

and

- (b) has satisfied the SRA that its beneficiaries have suffered, or are likely to suffer, hardship if a grant is not made.

3.10 A *person* is eligible under this rule to apply for a grant in the circumstances set out in rule 3.4(a) or (b) if the *person*:

- (a) at the time the application is made falls within one or more of the following categories:

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- (i) a *charity* with annual income net of tax in the most recent financial year of £2 million or more; or
 - (ii) a *trustee* of a trust with an asset value of £2 million or more;
- and

- (b) has satisfied the SRA that its beneficiaries have suffered, or are likely to suffer, hardship if a grant is not made.

3.11 Having regard to the discretionary nature of the Fund, the *SRA* may take into account such evidence as it sees fit when determining eligibility under rules 3.7 to 3.10 and may make a broad estimate of any relevant amount.

3.12 The *SRA* may summarily determine whether a *person* is eligible to apply for a grant.”

Rule 2

The SRA Handbook Glossary 2012 shall be amended as follows:

- (a) after the definition of “**trustee**” insert:

“**turnover**

in the *SRA Compensation Fund Rules* means the amounts derived from the provision of goods and services in the most recent financial year, after deduction of:

- (a) trade discounts,
- (b) value added tax, and
- (c) any other taxes based on the amounts so derived.”

Rule 3

These amendment rules shall come into force on 1 April 2015.



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Claimant Type	Application basis (Dishonesty, Failure to account and hardship)	Requirement	SRA Compensation Fund Rules 2011
Individual	Dishonesty	Need not show hardship	3.4(a)
Individual	Failure to account & hardship	Hardship presumed under Rules	3.5(a)
Businesses with a turnover not exceeding £2 million;	Dishonesty	Need not show hardship	3.4(a)
Businesses with a turnover not exceeding £2 million;	Failure to account & hardship	Generally unable to show hardship unless for example, a small family business	3.5(b)
Businesses with a turnover exceeding £2 million	Both categories of claim	Excluded	Draft 3.7
Charity - with annual income	Dishonesty	Need not show hardship	Draft 3.8



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of less than £2 million Trust - with a net asset value of less than £2 million			
Charity - with annual income of less than £2 million Trust - with a net asset value of less than £2 million	Failure to account & hardship	Need to demonstrate that beneficiaries have suffered, or are likely to suffer, hardship	Draft 3.9
Charity - with annual income of more than £2 million Trust - with a net asset value more than £2 million	Both categories of claim	Need to demonstrate that beneficiaries have suffered, or are likely to suffer, hardship	Draft 3.10