

APPLICATION TO LSB FOR APPROVAL OF COMPENSATION FUND CONTRIBUTIONS 2015

INTRODUCTION

1. This application is made by ILEX Professional Standards Ltd (IPS) under Schedule 4 of Legal Services Act to seek approval of the Compensation Fund contributions it proposes to charge entities that are authorised by it in 2015. The application is made under the rule approval process in respect of IPS' regulatory arrangements relating to its compensation fund arrangements.

ENTITY AUTHORISATION

2. IPS will open its entity authorisation application process with effect from 5 January 2015. From this date entities will be able to make an application to IPS to seek authorisation to deliver reserved or regulated legal services. The reserved legal services that IPS can award are the conduct of litigation and exercise of rights of audience; probate activities; and reserved instrument activities. The regulated legal services that IPS can award are immigration practice rights.
3. An entity seeking authorisation from IPS will pay an application fee. The application fee will cover IPS' activities in assessing the application. IPS' applications for practice rights set out details of its entity authorisation processes.
4. Where an application by an entity is successful the entity will become an IPS regulated entity. At that point they will be required to make a contribution to the compensation fund. IPS therefore seeks to implement the new arrangement as soon as it is approved.

COMPENSATION FUND CONTRIBUTIONS

5. IPS is setting up a compensation fund, the purpose of which is to provide redress to consumers who suffer a loss due to dishonesty or failure to account by a regulated entity.

Nature and effect of existing proposals

6. IPS received approval from the LSB for its proposal to set up a compensation fund as part of its regulatory arrangements for its entity regulation scheme through its practice rights applications. An Order was made under s69 Legal Services Act which provided the power to establish and maintain a compensation fund. The Order came into effect on 8 December 2014.

7. IPS has in place Rules relating to the compensation fund which were approved by the LSB following the Order made by Parliament. This is the first application by IPS to set the contribution to be made by entities to the fund.

Nature and effect of proposed alteration

8. This is an application to seek approval to introduce the compensation fund contributions from authorised entities to maintain the fund in accordance with Order.
9. The details of the proposed regulatory arrangement are set out below.
10. The fund has been set up with £1m designated by CILEx as a draw-down fund from its reserves. It will be overseen and managed by independent trustees through a company limited by guarantee. All regulated entities will make a contribution to the compensation fund to help build and maintain the fund. The fund is insured and IPS has a policy of insurance which is ready to incept on 5 January 2015.
11. IPS has applied a risk based approach to the level of contributions that regulated entities will make to the fund. The risks that IPS has taken into account are:
 - The area of law in which the entity will practice;
 - The level of proposed turnover;
 - Whether client money is held;
 - How client money is held – in client account or escrow.

Area of legal practice

12. IPS' work with insurers and experience in testing entity regulation indicates that risks in conveyancing and probate practice are higher than litigation and immigration practice. Therefore the level of contribution is higher for the higher risk practice areas.

Level of turnover

13. IPS' demand research, as set out in its practice rights applications, indicates that most entities it will regulate will be small. IPS' entity testing programme has also indicated that the level of turnover is a good indicator of the volume of work undertaken by an entity and therefore the level of exposure by volume to claims for compensation.
14. The payments to the compensation fund therefore increase according to level of entity turnover. In the first year of regulation the contribution will be based on projected turnover as disclosed in the entity authorisation application form where they are a new set up. The turnover for an existing entity will be assessed from its accounts.
15. The level of turnover increases on bandings of £100,000 for smaller entities and increases on bandings of £250,000 for larger entities.

Client money

16. IPS regulated entities have the option as to whether they hold client money. Entities may choose to:
 - hold client money in a client account;

- hold client money in an escrow account; or
- not hold client money.

17. The contribution to the compensation fund will be set according to the level of risk posed to client money. Where an entity holds client money they will pay the full contribution. This is because the evidence of regulatory decisions demonstrates that there is a risk of dishonest handling of client money. The aim of the compensation fund is to provide redress where such dishonesty occurs.

18. Where an entity holds client money in an escrow account their contribution has been reduced to recognise that the level of exposure to dishonest handling of client money is reduced. This is because a third party holds the client money on trust for the client and the entity. However, there remains a risk of diversion from the escrow account and therefore entities will make a contribution to the compensation fund.

19. Where an entity does not hold client money their contribution to the compensation fund is further reduced. This reflects the reduced risk of dishonesty posed by these entities.

The amounts

20. The table below sets out the contributions that entities will make.

Practice area	ENTITY TYPE			
	Turnover amount	Client account	Escrow	No client money
Litigation & immigration	Up to £100,000	600	450	300
Probate & conveyancing		800	600	400
Litigation & immigration	£100,001 - £200,000	800	650	400
Probate & conveyancing		1000	750	500
Litigation & immigration	£200,001 - £300,000	1000	750	500
Probate & conveyancing		1200	950	600
Litigation & immigration	£300,001 - £400,000	1200	850	600
Probate & conveyancing		1400	1050	700
Litigation & immigration	£400,001 - £500,000	1400	1050	700
Probate & conveyancing		1600	1200	800
Litigation and immigration	£500,001 - £750,000	1700	1300	850
Probate & conveyancing		2000	1500	1000
Litigation & immigration	£750,001 - £1,000,000	2500	1750	1250
Probate & conveyancing		3000	2200	1500
Litigation & immigration	£1,000,001 +	5000	3500	2500
Probate & conveyancing		6000	4400	3000

CONSULTATION

21. IPS has not consulted on the level of compensation fund contributions to be charged in year one of authorisation. This is because at present IPS does not regulate entities which it can consult. It will build up its regulated community during the course of 2015 and consult on future regulatory fees as part of its annual contribution approval submissions. Ordinarily IPS' approach to consultation is direct email and survey of the affected regulated community.

AIMS OF CONTRIBUTIONS

22. The aim of the contributions to be made by entities is to maintain and build up the compensation fund. The fund is managed by independent trustees. Its purpose is to provide financial redress to clients who have suffered loss and hardship.
23. The trustees will keep the fund under review, which will include the effectiveness of the level of fund contributions. In addition IPS' annual review of practice fees will include a review of the level of contribution to ensure that it is set at a level that will help to maintain the fund.
24. Under the Compensation Fund Rules the trustees may apply the fund money in accordance with the Rules alone. The fund money cannot and will not be used for any purposes falling outside of the Rules.

REGULATORY OBJECTIVES

25. The aim of the compensation fund is to set up a fund to provide redress to consumers who have suffered loss as a result of dishonesty or failure to account by an IPS regulated entity. They will support the regulatory objectives.
26. The contributions aim to build and maintain a fund. The fund will be used to protect and promote the interests of consumers who trust their money to IPS regulated entities. The interests of the public will also be protected as they will be able to consider seeking legal services from an IPS regulated entity with the awareness that IPS is able to protect their interests and provide redress. This therefore also improves access to justice in that the public and consumers are able to access services provided by IPS regulated law firms in the knowledge that redress will be available were it to become necessary.
27. The availability of a compensation fund enables IPS regulated entities to be an independent, strong and effective legal profession that can demonstrate to their clients that adequate redress is available to them.
28. The effect of this proposal on the other regulatory objectives and the professional principles is neutral.

BETTER REGULATION PRINCIPLES

29. The level of contribution meets the better regulation principles for the following reasons.
30. IPS has taken a proportionate approach to setting the level of contribution. Proportionality has been achieved by the tiered level of contribution according to the size of the entity by reference to turnover. Proportionality has also been achieved by reference to risk according to how an entity holds client money and the practice area in which it delivers legal services.

31. There will be accountability in respect of the compensation fund through the trustees. The trustees will be responsible for ensuring full accounting records are maintained of contributions and payments in and out of the fund. They will also ensure annual accounts are produced of the sums of money held in the fund.
32. IPS takes a consistent approach in setting the level of contribution with its approach to setting entity application fees. It intends to take a similar approach to annual practice fees for entities by introducing payments that take into account risks to client money, practice area and size of entity by turnover.
33. The approach to fees is targeted at risks as set out above. It is also transparent as the levels of contributions will be published on the IPS website and be made clear to entities seeking regulation by IPS.

REGULATORY CONFLICT

34. The compensation fund contributions are set by entity regulator. They will apply to IPS regulated entities only and there will be no conflict with other regulators, as entities have one legal services regulator only.

APPROVAL

35. IPS seeks approval of the proposed compensation fund fee structure.

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