



**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
16 July 2020**

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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 2020/21. 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 £14.5m (2019: £17.5m) would result in an individual contribution of £50 (2019: £60) and a firm contribution of £950 (2019: £1,150). This is a year on year decrease 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 the 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. In recent years we have deliberately increased the reserve in the Fund to take account of a number of high-value exceptional cases. Primarily, these arise from solicitor involvement in investment schemes where individual clients have potentially suffered significant losses. At the same time as increasing reserves we have seen a decline in the scale of interventions and claims which reduces the “business as usual”.
5. The calculation of the contribution uses the best view of predicted numbers and costs of interventions for the remainder of 2019/20 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. It also considers the changing landscape of the solicitor profession as a result of the Covid-19 outbreak.
6. 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

7. 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.

8. 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. Payment is required by 31 October for the following practising year.
9. 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).
10. 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. Our Finance and Audit committee reviews the nature of claims and any trends, level of reserves and budget for staff to handle the claims before making a recommendation to the Board. 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).

C. Nature and effect of the proposed change

11. The Finance and Audit committee, having gone through a detailed review, recommended that the funding requirement for 2020/21 should be £14.5m. The basis of this recommendation is included at annex A, which sets out the relevant financial analysis to support the need for £14.5m. Our Board considered and approved this on 20 May 2020. We now seek approval of the following determinations from the LSB:

Annex B: Determination of Compensation Fund contributions 2020

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

Annex C: Determination of Compensation Fund contributions for licensed bodies 2020

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

D. Rationale for level of contribution

12. 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.
13. Over the years, the level of contribution has varied, with sometimes significant increases, for example, during property recessions. The reserving policy referred to in annex A, and forecasting seeks, as much as possible, to avoid large swings and has been refined to take account of relevant, more specific information where available, with consideration given to additional high-risk potential liabilities. Additionally, this year the Covid-19 outbreak has brought a degree of uncertainty to the Fund that has not been present in previous years. The contribution has been set to provide a contingency for additional unforeseen risks.

14. The table below shows the expected cash inflows and outflows to the Fund for the remainder of the 2019/20 financial year and the 2020/21 year.

Compensation Fund forecast 2019-21	2019/20 (£000s)	2020/21 (£000s)
Income		
Compensation Fund contributions	1,330*	14,539*
Subrogated claims	4,298	8,849
Compensation Fund recoveries	1,642	1,900
Residual balances from STA's	725	693
Bank & investment income	155	122
Total income	8,149	26,102
Expenditure		
Compensation Fund Grants	19,494	17,917
Fees, tax and other costs	40	60
SRA support costs recharged	9,637	10,180
Total expenditure	29,172	28,157
Surplus / (deficit)	(21,023)	(2,055)
Opening balance	64,430	45,633
Closing balance	45,633	43,578

**As the majority of contributions are paid in advance of the practising year, the contributions collected in relation to the 2019/20 practising year was in excess of £17.5m. The majority of that amount was collected in the 2018/19 year. Although the £14.5m collection for 2020/21 is shown in that year, some cash will be collected during October 2020 and the actual year-end balance will be higher as a result.*

15. The reserve level (closing balance before exceptional cases) is established through an agreed formula and each year we calculate the level of reserves required for the following three years. We then consider exceptional cases and the fluctuations in contributions with the aiming of smoothing where possible. The level of contribution for 2020/21 has been decreased due to the high level of reserves in the fund but with the potential impact of the Covid-19 outbreak in mind.

E. Statement in respect of the Regulatory Objectives

16. 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

17. 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.

G. Statement in relation to desired outcomes

18. In decreasing the contributions towards the Fund, our aim is to make sure it is properly funded and maintained and able to meet claims without delay. The Fund is reviewed annually and is also subject to 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

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

I. Implementation timetable

20. The timetable is as follows:

- our Board finalised the Compensation Fund contributions in May and will confirm the determinations at its meeting in July before seeking LSB approval
- during August, final preparations for this year's renewal exercise will be made, and, on 1 October 2020, firms and individuals will be contacted and asked to make the various renewal applications online
- firms and individuals must submit the relevant Compensation Fund contributions and other fees by 31 October 2020

J. Stakeholder engagement

21. As is standard practice, a comprehensive communications plan was drawn up to promote the determination of the 2020/21 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 availability of the fees calculator to help them
- the level of fees to be collected

22. This was on top of a specific consultation exercise around Compensation Fund arrangements that took place in January. That exercise involved promotion of the consultation through trade media, social media and focus groups with consumers, including a special event in Chester.

23. The following elements of the communications plan for fees have been delivered or are scheduled for delivery:

October 2019 – We launched a comprehensive consultation on our Corporate Strategy for 2020-2023, which outlined our priorities for the next three years. Respondents to our consultation had the option of influencing directly what we would be doing and therefore what our budget would be.

The consultation was publicised by:

- A press release sent to all legal press
- Social media messages
- Promotion through our various newsletters, with a reach of up to 200,000 recipients
- Workshops with legal entrepreneurs,
- Workshops with small businesses
- Workshops with consumer representative groups
- Meetings with the elderly and people who do not speak English as a first language
- Meetings with young people who have been homeless or been through the criminal justice system
- A survey with more than 400 solicitors and consumer representatives

In June, there followed a more intense period of communications activity which included:

- 8 June - The Law Society Group published its net funding review consultation
- The consultation was publicised through media releases by both us and the Law Society.
- It was promoted through social media posts – including LinkedIn, Facebook and Twitter, also promoted this consultation.
- Further promotion came through our newsletters, with a reach of 200,000. They were sent out in June and July
- The Law Society's Professional Update, its weekly newsletter, promoted the consultation every Friday
- The SRA launched its own consultation on its Business Plan, which sets out the activities it will undertake to achieve the ambitions laid out in the Corporate Strategy. This was promoted in the same ways listed above
- Non-commercial organisations – which do not pay an authorisation fee to the Group but nevertheless can sometimes pick up the practising fees of those working for them – were contacted via email encouraging them to respond to the consultation

Once the consultation has ended and responses analysed and fed back to the relevant organisations, we will undertake the following activity:

- 14 July – following the SRA Board's agreement for the fee-collection mechanism, we update the fees webpage on the SRA website (with caveat that LSB still needs to approve), which explain how fees are spent, an online fee calculator, a revised turnover table and indicative Compensation Fund contributions. This will be promoted through SRA Update.
- Mid-August – following LSB decision/approval update of web materials confirming fees.
- September – large-scale communications will be sent to firms ahead of the renewal period, including a special edition of our newsletter on 9 September.

24. The consultation on the SRA 2020/21 Business Plan¹ includes the principles for setting the level of contributions to the Compensation Fund. Once agreed these principles will inform the contribution setting process in future years and provide greater clarity for fee payers in future years and help to explain the rationale behind any changes to the fees over time.
25. Because of the pandemic lockdown, we were not able to arrange focus groups as we had done in the more substantial consultation exercises held earlier in the year. The consultation will close on 26 August 2020. The principles will be finalised later this year and will be referred to when setting the 2021 contribution levels.

Contact for matters relating to this application

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Annexes

Annex A - Basis of recommendation

Annex B - Determination of Compensation Fund contributions 2020

Annex C - Determination of Compensation Fund contributions for Licensed Bodies 2020

¹ <https://www.sra.org.uk/sra/consultations/consultation-listing/business-plan-2020-21>

Annex A – Basis of recommendation

Compensation Fund Contribution for 2019/20

Recommendation

- 1 The SRA Board approved the contribution to the Compensation Fund (“the Fund”) for 2020/21 at £14.5m resulting in:
 - Individual contribution £50 (2019/20 - £60)
 - Firm contribution £950 (2019/20 - £1,150)

Background and Approach

- 2 The Fund pays discretionary grants to people who have lost money as a result of dishonesty or failure to account by solicitors or law firms. It also has jurisdiction to pay discretionary grants to people who cannot recover damages from a solicitor or law firm because of a failure to obtain indemnity insurance. That was put in place following the abolition of the Assigned Risks Pool (ARP) which provided similar cover. Very little has been paid out under the new jurisdiction. It is referred to as ‘uninsured loss’ in this paper.
- 3 Each year, the Board decides how much to raise from law firms and individuals to finance the Fund.
- 4 It is the long-standing approach of the Fund, agreed by the Finance and Audit Committee and the Board, to maintain an appropriate reserve fund as a contingency against unexpected numbers of claims or unexpectedly large claims.

Position as at 31 March 2020

- 5 Total grant payments for the practising year 2018/19 were £7.5m (£17.9m 2017/18).
- 6 Forecast grant payments for this practising year (2019/20) are £19.5m.
- 7 The gross value of open claims received as at 31 March 2020 was £70.8m (£67.8m 31 March 2019). We forecast that in the year 2019/20 we will pay grants of £19.5m (£7.5m 2018/19). It is normal for the gross value of claims to be much higher than what is eventually paid. Claimants often seek much more compensation than is actually payable from the Fund.

Claims for uninsured loss

- 8 These are applications to the Compensation Fund (from October 2012 and following closure of the ARP at the end of September 2013) for losses suffered as a result of the civil liability of a firm which did not have insurance against which claims could be made. Capita deals with these claims on our behalf because of their experience of handling negligence claims which they also deal with as manager of the ARP.
- 9 As at the end of May 2020 there have been a total of 116 claims (106 claims May 2019), of which 9 are currently under investigation with a total claim value of £2.16m.

High value contentious claims

- 10 As detailed in previous applications, a decision was taken in 2018 to significantly increase the total level of contributions and therefore the reserve levels. This was because of an assessment that future payments were likely to increase above the historic trend as a result of claims arising from dubious investment schemes.
- 11 This year we have again assessed the position of high value contentious cases relating mainly to dubious investment schemes. Whilst the potential liability associated with these cases remains significant, both the forecasted maximum level of claims and the overall risk profile have reduced.
- 12 It remains the case that whilst the Fund is not likely to make payments on a number of cases, it is possible that this position could be challenged given the amounts involved
- 13 The Finance and Audit Committee were presented with an update on the anticipated liabilities for these cases and the likelihood and value of any potential claims on the Compensation Fund. The level of funds required to provide a prudent level of cover for these cases was reviewed and debated.
- 14 As a result, the agreed contribution levels and the resulting forecasted reserves are considered to provide adequate contingency to meet the expected liabilities of the high value contentious cases.

Covid-19 impact

- 15 It is not possible to predict the impact on the profession or the Compensation Fund of the Covid-19 outbreak, but it is reasonable to expect that the lack of economic activity will impact on all firms and may cause some to close. The most immediate impact on the fund will be if these closures do not happen in an orderly manner and we are forced to intervene.
- 16 Given the ongoing uncertainty it is difficult to quantify the impact but, for illustration purposes, a 50% increase in interventions would increase costs recharged to the fund by around £3.5m per year; this of course assumes that the interventions are similar to those undertaken and this remains to be seen.
- 17 Increased firm closures may also lead to higher grant payments from the fund, again the impact of this is not possible to quantify at this stage but the effect may be staggered over a relatively long period.
- 18 Over the last 15 years the highest amount paid in grants was £27m in 2010. An increase to these levels again would be £9m higher than included in the current forecast.
- 19 These risks were considered by the Finance and Audit Committee and the decision was reached that the proposed contribution levels and the forecasted reserves are adequate to provide sufficient contingency to meet these risks.

Other Payments from the Fund

- 20 We charge a range of overheads to the Fund. The recharges included as costs to the Fund are included as recoveries in the SRA funding requirement.

Impact of the new Compensation Fund Rules

- 21 We concluded a further consultation on revisions to the Compensation Fund rules in April 2020. The responses from the consultation are now to be considered by the board. The impact of any changes resulting from the revised rules will not change the position of the existing high value contentious matters and have therefore not been considered in the recommendation for the level of contribution in 2020/21.
- 22 Any changes from the reforms will not be implemented until later in the year and are unlikely to be applied retrospectively. However, if agreed, the reforms are likely to lead to lower contributions at some point over the next 5 years.

Calculation of Recommended Contribution for 2020/21

- 23 As in previous years, the recommended contribution has been calculated by taking the opening balance of money held in the Fund and then taking account of:
- calculation of the appropriate reserve required (see paragraph 25-26)
 - forecast cash outflows (i.e. grants and costs – see paragraph 31-32)
 - forecast cash inflows (excluding the contribution – see paragraph 33-35)
- 24 This leads to the required contribution being identified as a balancing figure.

Appropriate Reserve

- 25 At Finance and Audit Committee in February 2017, we agreed to refer to the 'appropriate reserve' which is defined as being the formula based 'minimum reserve' plus further reserves which provide contingency for exceptional matters.
- 26 The calculation used for the appropriate reserve produces the following figure for 2020/21:

•	(1.5 x weighted average grants in previous 7 years) + (3 months' costs)	
Being:	£23.1m (1.5 x £15.4m) + (£2.5m) =	£25.6m
	Plus additional contingency for Covid-19 impact and high value contentious claims	£20.0m
	Total Reserve	£45.6m

Future Claims and Costs

- 27 The main factors in forecasting grants are the numbers of current claims and expected future claims. The latter is determined by the expected number of interventions.
- 28 For the purpose of this calculation, we have assumed that there will be 42 interventions in this and subsequent practising years. This cautious estimate is based on the number of interventions over the last three years and the number of interventions year to date and expected activity for the rest of the year.

- 29 Interventions also account for the bulk of the costs paid by the Fund. We liaise closely with several internal departments on potential interventions to help forecast future intervention costs more accurately (as well as to prepare operationally). Forecasting intervention numbers beyond that is very difficult.
- 30 We have seen a slight increase in the number of interventions in the first seven months of this financial year. The interventions themselves continue to be smaller and less complex in nature than seen historically. The volume and complexity of the interventions both have an impact on the costs charged to the Fund and also the level of claims made.

Costs paid from the Compensation Fund

- 31 The amount forecast to be paid from the Fund for 2019/20 is £9.6m based on the intervention costs included in the SRA budget.
- 32 For 2020/21 the predicted recharge is £10.2m. This is made up of £7.0m intervention costs and the remainder is staff related costs and a share of support costs.

Cash Inflows

- 33 The main cash inflows to the Fund (excluding contributions) are transfers from Statutory Trust Accounts (STAs) through rights of subrogation and the transfer of residual balances.
- 34 Based on evidence of previously closed STAs and the ongoing work on live accounts, subrogated and residual funds are expected to total £4.3m in this year and £8.8m next year.
- 35 Money is also recovered from intervened solicitors or from claims against the indemnity insurer of an intervened firm. Recoveries are forecast at £1.6m in 2019/20 increasing to £1.9m in 2020/21.

Recommended 2020/21 contribution

- 36 The recommended contribution is £14.5m, which is £3.0m lower than last year.
- 37 For the purposes of calculating an individual and firm contribution it has been assumed that there will be the equivalent of c.145,000 individuals paying a contribution and approximately 7,600 firms paying a contribution.
- 38 Based on these figures, a collection of £14.5m would result in an individual contribution of £50 and a firm contribution of £950.
- 39 The forecasts are based on the currently available information and may change as we move through the next financial year.
- 40 We continue to closely monitor the development of these cases and as the position becomes clearer on each we will review and update future forecasts. The full impact of the Covid-19 outbreak is evidently unclear at the time of this application. The contribution has been set at a level that ensures a significant level of reserves to provide for this uncertainty.

Supporting information

Links to the Strategic Plan and / or Business Plan

- 41 This proposal relates to our strategic objective to “improve our operational performance and make fair and justifiable decisions promptly, effectively and efficiently” in the context of ensuring the operation of an effective and efficient Compensation Fund.

How the issues support the regulatory objectives and best regulatory practice

- 42 A properly run Compensation Fund provides transparency and accountability.

What equality and diversity considerations relate to this issue

- 43 The level of the contribution to the Compensation Fund is likely to have a greater impact on sole practitioners and firms with 2 - 4 partners and therefore indirectly for BAME solicitors who are disproportionately represented in this cohort. Unlike the firm Practising Certificate fee which is calculated by turnover. We are reviewing our general approach to funding and fees during 2020 and will consider the implications of changes to the Compensation Fund funding as part of any wider changes.

Annex B - Determination of Compensation Fund contributions 2020

This determination is made by the Solicitors Regulation Authority Board under rule 1.2 of the SRA Compensation Fund Rules, 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 2020, 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 2020, shall pay with the fee payable in respect of that application, a contribution of £50 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 2020 to 31 October 2021, shall pay with the annual periodical fee, a contribution of £950 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 2020 to 31 October 2021; and
 - (b) intends to hold or receive client money (as defined in the SRA Accounts Rules) at any time during the period 1 November 2020 to 31 October 2021.shall pay with the fee payable in respect of that application, a contribution to the Fund as follows:
 - i. £950 on applying for initial recognition to commence in the period 1 November 2020 to 31 December 2020;
 - ii. £712 on applying for initial recognition to commence in the period 1 January 2021 to 31 March 2021;
 - iii. £475 on applying for initial recognition to commence in the period 1 April 2021 to 30 June 2021;
 - iv. £237 on applying for initial recognition to commence in the period 1 July 2021 to 31 October 2021.
- (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;

All other terms are to be interpreted in accordance with the Practising Certificate Fee Determination 2020.

(6) This determination shall come into force on 1 November 2020.

Annex C - Determination of Compensation Fund contributions for Licensed Bodies 2020

This determination is made by the Solicitors Regulation Authority Board under rule 1.2 of the SRA Compensation Fund Rules, 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 2020 to 31 October 2021, shall pay, with the annual periodical fee, a contribution of £950 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 2020, shall pay, with the initial periodical fee, a contribution to the Fund as follows:
 - i. £950 on applying for initial recognition to commence in the period 1 November 2020 to 31 December 2020;
 - ii. £712 on applying for initial recognition to commence in the period 1 January 2021 to 31 March 2021;
 - iii. £475 on applying for initial recognition to commence in the period 1 April 2021 to 30 June 2021;
 - iv. £237 on applying for initial recognition to commence in the period 1 July 2021 to 31 October 2021.
- (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;

All other terms are to be interpreted in accordance with the Licensed Body Fee Determination 2020.
- (5) This determination shall come into force on 1 November 2020.