

Application made by the Solicitors Regulation Authority Board to the Legal Services Board under Part 3 of Schedule 4 to the Legal Services Act 2007, for the approval of changes to regulatory arrangements relating to the SRA's Compensation Fund arrangements

A. Summary

1. This application is made by the Solicitors Regulation Authority (SRA) to the Legal Services Board (LSB) for approval of changes to the SRA's regulatory arrangements, namely the new SRA Compensation Fund Rules 2020 (CFRs) (attached at Annex 1).
2. The rules that govern how we review the Fund have not been substantively reviewed in around 20 years. Our Board therefore decided to review the regulatory arrangements relating to the Fund, with a view to making sure that they are up to date, fit for purpose and effective in light of their statutory purpose and best regulatory practice. Our approach has also been informed by looking at the scope of and levels of protection available with other regulatory schemes. Our Board took a fresh and principled look at the rules. The statutory basis of the arrangements means that the SRA has discretion to formulate the regulatory arrangements which set out the scope and operation of the Fund and how applications might be determined.
3. After two consultations, having listened to stakeholders' views and revised some of our proposals in response, our Board has agreed a set of changes. These changes we have concluded provide a proportionate level of consumer protection, targeting the discretionary fund on individuals and small business and introducing mechanisms to manage its liability to make sure it remains viable at a fair and stable cost to the profession. Our Board has sought to future proof the Fund in light of changing claims patterns and economic circumstances. The cost of the Fund is borne entirely by the profession and our changes are designed to make sure the regulatory burden on firms of contributions are proportionate and remain so in the future.
4. We have therefore set out a clear position throughout the consultation process that the Fund cannot, and never was intended or required to assume, an open ended-ended liability to meet any unsatisfied loss by any party caused by the actions of a solicitor. We are clearer upfront where a loss is not covered by the Fund and people cannot make a claim, reducing the likelihood that consumers expectations are raised but their claims are unsuccessful. Our current eligibility test are complex and we have sought to simplify them, remove hardship tests to target the Fund on consumers of legal services, who are less able to take steps to protect themselves when they suffer direct loss as a result of unethical behaviour by a solicitor. This means we treat all eligible applicants consistently, widening the scope for small businesses and charities and trusts. Many small businesses do not currently proceed with claims when asked for financial information.

B. Background

5. The Legal Services Act 2007 requires approved regulators to have appropriate insurance and compensation arrangements. Compensation arrangements are defined in s.21(2) as being “...to provide for grants or other payments for the purposes of relieving or mitigating losses or hardship suffered by persons in consequence of—
 - (a) *negligence or fraud or other dishonesty on the part of any persons whom the body has authorised to carry on activities which constitute a reserved legal activity, or of employees of theirs, in connection with their activities as such authorised persons, and*
 - (b) *failure, on the part of regulated persons, to account for money received by them in connection with their activities as such regulated persons...*”.
6. In addition to this, the Solicitors Act 1974 (the Act) gives the Law Society the discretion, delegated to the SRA, to make rules concerning compensation grants in relation to a loss that a person has suffered, or is likely to suffer, as a result of an act or omission of a solicitor and their employees. The Act allows the Fund to be used to make payments for any costs, charges or expenses incurred when we have exercised our intervention powers. The Act provides that we establish and maintain a fund for these purposes.
7. The Act also specifies that, among other things, our rules may provide:
 - a. The circumstances in which grants may or may not be made.
 - b. Minimum and maximum grants payable in respect of a claim.
8. The SRA therefore has the discretion to formulate the regulatory arrangements which set out the scope and operation of the Fund and how applications might be determined.
9. The Fund is a discretionary fund of last resort and is financed by annual contributions from solicitors and law firms that we regulate¹. The costs of these contributions are likely to be ultimately reflected in the price of legal services.
10. Completing the review of our compensation fund arrangements is the final strand of our Looking to the Future regulatory reform programme, which brought in the SRA Standards and Regulations. This programme has fundamentally reviewed our approach to regulation. The Fund has been operating for nearly 70 years, with no substantive review for around 20 years.
11. A key aim in conducting this review has been to provide proportionate consumer protection, prioritising the discretionary fund and managing its liability to make sure it remains viable to protect the consumers, who most need it at a fair and stable cost to the profession. This is particularly important in light of changes in the legal market,

¹ as set out in Solicitors Act 1974 section 36A(2): “Compensation rules may require solicitors, or solicitors of a description prescribed in the rules, to make contributions to compensation funds of such amounts, at such times and in such circumstances, as may be prescribed in or determined in accordance with the rules.”

consumer behaviour and the risks that give rise to applications for a payment from the Fund changing. For example, we have been seeing cases with large numbers of high value claims from people that are connected to the same investment scheme. Our view that it is fairer and more transparent to have a Fund that operates in a way that is easily understood.

12. There seems to be an ongoing friction between the SRA's regulatory aim to provide proportionate consumer protection and that the Fund should meet every loss caused by a solicitor. We, therefore, wanted to make sure that we simplified our arrangements so that they are proportionate, clearly targeted and with an easily understandable purpose. This will support our decision making in this area. As set out in later sections, we have identified several issues with the existing arrangements that we wanted to address. A review against the regulatory objectives and the better regulation principles was therefore timely.
13. Our review has resulted in the following key features:
 - a. A purpose statement which provides clarity that the Fund will help people that have lost money due to fundamental ethical failures by those we regulate.
 - b. Simplified eligibility criteria:
 - Focusing on the individual and small business consumers most in need of protection. This is what our focus groups have signalled should be the case, is a criterion easily understood across different sectors and is more closely aligned to, for example, the scope of the Legal Ombudsman Scheme.
 - Not requiring hardship to be demonstrated within any category of eligible applicants.
 - c. Fair and transparent maximum pay out levels, which are equal to, or exceed, limits in most other comparable schemes.
 - d. The ability to cap payments where there are multiple applications arising out of a single or connected events, an approach well known from other sectors and which allows us to apportion payments fairly while controlling our level of liability and therefore, contributions year to year.
 - e. A more user-friendly application process.
 - f. Limiting payments to provide for redress for the direct financial loss caused by the solicitor or law firm, so for example the amount of stolen money in a probate case or the value of property lost in a fraudulent conveyancing transaction.
14. We have consulted twice on our proposal: first in March 2018², and a further consultation in January 2020³. Our Board made the proposed regulatory

² <https://www.sra.org.uk/sra/consultations/consultation-listing/access-legal-services/?s=c>

³ <https://www.sra.org.uk/sra/consultations/consultation-listing/comp-fund-reform-2020/?s=c>

arrangements at its meeting in July 2020. The Board paper and annex is attached at Annex 2(i) and (ii).

C. Details of the SRA’s current regulatory arrangements

15. The Fund makes payments to those affected when individuals or firms misappropriate or fail to account for money when they have no other route to redress. The Fund is a discretionary fund and our rules set out for example, that grants will not be made where the applicant is not eligible to make a claim or has another means to recover their loss. This might be where, for example, the loss is covered by professional indemnity insurance.
16. The current scope of possible payments from the Fund is wide. The current eligibility criteria and where we apply hardship tests is set out in the table below. They vary depending on who the applicant is (i.e. a private individual, a business, or a charity) and the cause of the loss (dishonesty, hardship caused by a failure to account for money, or an uninsured loss).

Applicant Type	Loss due to the dishonesty of a regulated person	Failure to account for money causing hardship	Loss which should have been insured
Private Individual	Eligible	Eligible – will deem hardship	Eligible
Business with turnover more than £2m a year	Not eligible	Not eligible	Not eligible
Business with turnover less than £2m a year	Eligible	Eligible if able to show hardship	Eligible
Charity with an annual income or trust with annual assets more than £2m a year	Eligible if able to show hardship to its beneficiaries	Eligible if able to show hardship to its beneficiaries	Eligible
Charity with an annual income or trust with annual assets less than £2m a year	Eligible	Eligible if able to show hardship to its beneficiaries	Eligible

17. The current rules mean that eligible claims are not limited to losses incurred by only the client of a law firm. For example, a barrister instructed on behalf of a client can make a claim for unpaid fees. Applications might also include claims for other purposes, such as:

- the cost of seeking professional help to complete an application to the Fund
 - paying grants for litigation costs people have incurred in trying to recover losses from other sources, for example the firm itself, or
 - providing access to financial redress where a firm fails to have a valid policy of indemnity insurance in place (which otherwise would have paid the claim).
18. There is no automatic right to a payment. In exercising our discretion, we consider a range of factors, including whether the:
- loss can be made good by some other means
 - activities, omissions or behaviour of the applicant has contributed to the loss being claimed from the Fund
 - loss results from the combined activities of more than one party (for example a solicitor conspires with a surveyor to conduct mortgage fraud).
19. This means that every claim is considered on its merits and we can reject or reduce a payment. For example, a payment will only reflect the proportion of the loss that is directly attributable to the acts of the solicitor or firm. We also expect that claimants are honest when requesting a payment. Where they fail to provide complete information, this can result in lengthy investigations and costly legal challenges.

D. Nature and effect of the proposed alterations to the SRA's regulatory arrangements

20. Our consultations have provided the opportunity to take a fresh and principled look at the rules that govern how we operate the Fund.
21. Our aim in conducting this review has been to provide transparent, proportionate consumer protection, prioritising the discretionary fund on individual and small organisation consumers that need it the most. In doing so we are managing its liability to make sure it remains viable at a fair and stable cost to the profession and can therefore continue to play a vital role in protecting consumers of legal services. The changes make the boundary of the Fund more easily understood, so consumers can be more certain about when a payment will be made.
22. This contrasts with the view put forward by a number of our stakeholders that the Fund should meet every loss caused by a solicitor when there is no other redress available.
23. We are clear that the Fund cannot be and was never "*...intended or required to assume an open ended-ended liability to meet any unsatisfied loss by any party caused by the dishonesty of a solicitor...*"⁴. Like other regulators that operate a fund, we must make prioritisation decisions, and this includes, for instance, not using the Fund to replicate other existing debt recovery and claims processes. We think it is

⁴ R v Law Society ex p Mortgage Express [1997] 2 All ER 348, Lord Bingham CJ delivered the judgement to the Court

fairer to consumers and more transparent for us to prioritise the Fund through rules around its operation rather than on a case by case basis through decisions on individual applications. This means that the Fund should operate in a clearer way so that people know what loss is and is not covered by the Fund and who is eligible to make an application, thereby reducing the likelihood that peoples' expectations are raised but their applications are unsuccessful.

24. Taken together, the changes that we have made make sure that:
- a. **The Fund is focused on consumers:** The Fund is focused on helping those people that have lost money because of the ethical failures of solicitors and law firms providing them services. These are people who are least able to take steps to protect themselves when something goes wrong.
 - b. **There is greater transparency about when a payment is likely to be made:** We draw the boundary of the scope of the Fund in a way that is now more easily understood, including when a grant might be refused or reduced. This has meant resisting expanding its reach to try and cover all circumstances where a consumer may otherwise suffer a financial loss. This means we are clearer upfront where a loss is not covered by the Fund and people cannot make a claim, reducing the likelihood that consumers claims are unsuccessful. Our Impact Assessment shows that currently for claims under £500,000 the proportion of claims where we make a payment is only 45%.
 - c. **Consumers have greater certainty about the level of payment that is likely to be made:** We provide a proportionate level of redress whilst taking steps to 'future proof' and maintain the viability of the Fund. We may see a rise in both the number and value of claims in the future as has happened in the period after previous economic recessions, so its future viability is essential. The changes to limits and introduction of a capping mechanism compare favourably with other schemes.
 - d. **We are treating eligible applicants fairly:** We are making the application process as simple as possible. We have also removed hardship tests from our eligibility criteria, so that all eligible applicants are treated consistently when they are making a claim. This widens the scope of the Fund for small businesses and charities and trusts.

25. We summarise the rationale for the specific changes to our regulatory arrangements in the table below, including reference to the regulatory objectives. Further detail is provided in the application and annexes and we provide cross references throughout the application. A fuller analysis against the regulatory objectives is included at section F of the application, which sets out the analysis for the package of changes as a whole rather than for each specific change as our review has not considered changes in isolation. We emphasise the regulatory objective of protecting and promoting the interests of consumers. And also by making sure the cost burden on firms is proportionate the changes also promote competition and access to affordable legal services. The changes target the Fund on individuals and small businesses and charities and trusts to deliver proportionate protection to those who need it the most. This is well established in the better regulation principles. By prioritising in this way, we have established a much more transparent boundary for the Fund that means that we are treating all consumers consistently and create confidence that the Fund will remain accessible to provide this level of protection in the future.

Current status	Change	Rationale and mitigation
<p>Eligibility – who can make a claim on the Fund</p> <ul style="list-style-type: none"> • Certain categories of eligible applicant need to show hardship in order to receive a payment from the Fund, for example small businesses and charities where a solicitor has failed to account for money. For other categories such as individuals, we deem hardship to have been suffered. • Large charities with an income and trusts with assets over £2m can make a claim if they are able to show hardship to its beneficiaries. 	<ul style="list-style-type: none"> • Removal of any hardship tests. We will have discretion to refuse or reduce payments when we consider the loss to be disproportionately low or appropriately compensated elsewhere. • Exclusion of large charities and trusts from being eligible to claim in line with our approach to large businesses. 	<p>To focus the Fund on individuals, small businesses, charities and trusts that need most protection. The removal of hardship tests means we are treating applicants consistently and there is a reduced burden for small businesses and charities to demonstrate they are eligible to claim. Currently a significant proportion of small businesses discontinue their application when asked for financial information. This meets the regulatory objective to protect and promote the interests of consumers.</p> <p>We take the view is that large charities and trusts should be subject to consistent eligibility criteria as large businesses. This is because similar to a large business a large charity or trust is likely to have access to the expertise necessary to put in place, monitor and review a reserve or financial policy that builds the resilience to manage the risk and impact of missing money for example legacy donations. They will also have knowledge of how the money might be recovered. Many other compensation schemes we have reviewed take the same principled approach when considering how to target consumer protection.</p>

		<p>We will use our residual discretion to allow us to consider those rare cases in which the impact of loss is disproportionately low or adequately compensated elsewhere, and it would not be appropriate to meet it from a finite and discretionary fund.</p> <p>This meets the regulatory objective to protect and promote the interests of consumers.</p>
<p>Prioritisation – being clearer about the core purpose and focus of the Fund</p> <ul style="list-style-type: none"> • Barristers and professional experts can make a claim on the Fund including those that have not received any services from the defaulting solicitor. • Where a firm does not have insurance cover in place because of the insurers insolvency, an application to the Fund can be made. • 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. 	<ul style="list-style-type: none"> • Limiting claims to people for whom the legal service has been provided and in certain circumstances the party on the other side of a legal matter. • Being clearer about the circumstances where we make payments where insurance is not in place. • Clarifying our expectations around the conduct and behaviour of applicants and how we take this into account when deciding whether to refuse or reduce a payment. 	<p>We have established a clear boundary and priorities for making a payment from the Fund to make sure it is viable at a stable and reasonable cost means consumers are protected now and in the future. So we have targeted the Fund’s core purpose on covering losses to consumers of legal services due to fundamental ethical failures of the solicitor, moving away from any assumption that it should be available in any circumstance or to any party who has lost out due to the actions of a solicitor or firm.</p> <p>We continue to allow applications in certain circumstances from a party on the other side of a legal matter where the solicitor had failed to use funds for the purpose intended to complete a transaction for their benefit, or to make a settlement or other payment to them. This support the regulatory objective of supporting the constitutional principle of the rule of law. It recognises that the effective operation of the legal system requires mutual reliance and trust between solicitors on each side of a transaction or dispute.</p> <p>Our approach already is to take account of when a consumer has been in part or wholly responsible or contributed to the financial loss incurred. This is increasingly relevant particularly in the context of investment fraud and we have therefore we have made changes that mean we can take a more robust approach and to set out our expectations clearly to consumers.</p>

		<p>This meets the regulatory objective to protect and promote the interests of consumers.</p>
<p>Payment limits – to maintain viability of the Fund at stable and proportionate cost to the profession</p> <ul style="list-style-type: none"> • Claims can be made for up to £2m • Connected claims are not subject to a cap. 	<ul style="list-style-type: none"> • Reducing the maximum payment for a single grant from £2m per claim to £500,000 per claim, setting out transparently how we decide whether the maximum payment limit has been reached for each application (paying higher only in exceptional circumstances). • Introducing a capping mechanism for multiple high value connected claims above a £5m threshold and fix the cap at £5m, apportioning it across the claims taking into account the specific circumstances of each case. 	<p>The changes are to make sure that the Fund is viable for the future at a stable and proportionate cost to the profession. This in turn allows firms to compete in the market whilst maintaining proportionate consumer protection.</p> <p>We consider the new limit to be a fair and proportionate maximum payment level, which compares favourably against comparable schemes including those of other legal services regulators and for other professional services. A very small number of consumers will see a reduced level of protection, but it will cover the vast majority of claims made on the Fund.</p> <p>For the same reasons, we have also introduced a mechanism that allows us to manage the potential liability to the Fund presented by high value connected applications such as those related to property and other investment schemes.</p> <p>If we see an economic downturn in the coming months and years, this could result in more applications to the Fund. The changes we are making will help make sure we pay a fair proportionate amount to eligible applicants without imposing significant increases to fee contributions, which may be less affordable in a downturn.</p> <p>This balances the regulatory objectives by providing proportionate consumer protection at proportionate cost to the profession and so promoting competition across the market and access to legal services.</p>

<p>Costs – limiting grants to direct losses</p> <ul style="list-style-type: none"> • The Fund allows applicants that intend to or have already instituted legal proceedings for recovery of their loss to apply for a grant in respect of the costs of the proceedings provided they are necessary and proportionate. • An application may be made for the costs incurred by the applicant in connection with the preparation, submission, and proof of the application to the Fund. 	<ul style="list-style-type: none"> • Paying litigation costs only in exceptional circumstances. • Not making payments for costs associated with making an application to the Fund. 	<p>Our changes prioritise payments that provide redress for direct financial losses and clarifies the core purpose of the Fund.</p> <p>Our processes already take into account the circumstances of the claimant in deciding whether it is proportionate to expect them to pursue other avenues of redress including the court. In this context we are therefore maintaining the right to pay some costs on an exceptional basis, proportionate to the nature of the application.</p> <p>To minimise any negative impact on consumers, we are implementing a comprehensive programme of work to help people make an application to the Fund without professional support. This is well progressed, and we are confident that the improvements make the application process as straightforward as possible. This includes a complete redesign of the application form and new web material. We are ready to start testing this with consumer organisations and the public.</p> <p>It is important that consumers understand their rights and duties. The material that has been developed explains how we make our decisions and the factors we consider when assessing applications for a payment from the Fund. We are also updating our processes to provide more direct support to applicants to help them present the facts of the claim so we can then make a fair and robust decision.</p> <p>This balances the regulatory objectives by prioritising the scope of the Fund in a way that provide proportionate and targeted consumer protection at proportionate cost to the profession and so promoting competition across the market and access to legal services.</p>
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26. The rationale and effect for each proposed alteration is discussed in more detail in the following paragraphs. This draws heavily on the supporting evidence and analysis we published with the second consultation (Annex 3) and our final Impact Assessment (Annex 4) of this application.
27. We also provide a table at section I of this application that summarises how we have considered stakeholder feedback in arriving at the final changes to the arrangements. This table also cross references to more detail in Annex 6 (i) and (ii) submitted with this application.

Eligibility: removal of hardwired hardship tests

28. At present our rules require certain categories of eligible applicant to show hardship in order to receive a payment from the Fund, for example small businesses and charities where a solicitor has failed to account for money. For other categories such as individuals, we deem hardship to have been suffered. Our focus groups with consumers confirmed our view that the current position lacks consistency and is hard to understand. The change to regulatory arrangements will remove the necessity for eligible applicants to show hardship putting all applicants on a level playing field.
29. Under the current criteria less than 10% of applicants are required to demonstrate hardship⁵. We most often ask applicants for a financial statement for matters relating to counsels' fees and business conveyancing transactions that relate to, for example, a buy to let purchase. In around 80% of these types of applications, when we write to request financial information, we do not receive a response and we close the application. The requirement to submit financial information, therefore, may act as a deterrent to pursuing an application for payment.
30. We expect that by having a level playing field and reducing the burden we will see an increase in applicants from small businesses, charities and trusts that complete the process of making a claim and provide all information necessary.
31. We will use our residual discretion to not pay or reduce payment where we have evidence that the impact of the loss is disproportionately low or has been appropriately compensated through another means, for example, another compensation scheme or a payment from an insurer, or for any other reason that would mean that the loss is immaterial when viewed in context of the applicant's wealth or circumstances. We consider that this power will be used in very rare circumstances because losses would likely be material to most applicants. Specifically, for individuals, we presented analysis in the second consultation of the general financial position of UK households to emphasise this point⁶.

⁵ We do not have a set threshold for what "hardship" means in practice and that we do not operate any type of "means tested" assessment usually associated with hardship tests.

⁶ Paragraph 81 of the SRA consultation:

<https://www.sra.org.uk/globalassets/documents/sra/consultations/protecting-legal-services-prioritising-payments-sra-compensation-fund-consultation.pdf?version=48f5a8>

Eligibility: large charities and trusts

32. The change to regulatory arrangements will mean that large charities with an income and trusts with assets over £2m will no longer be able to make an application for payment.
33. This is likely to impact on charities and trusts above this size who lose money at the hands of a solicitor or law firm, who cannot obtain redress through other means and who would have made a claim in the Fund under the current arrangements. This may have a subsequent impact on the beneficiaries of the charity or trust if they cannot mitigate the loss.
34. Our view of the impacts is that large charities and trusts will operate in a similar manner to large businesses who are excluded from eligibility to the Fund. They are likely to have strong governance. They are likely to be regular users of legal services and be in a position to make sophisticated purchasing decisions, understand the risks involved and be able to put safeguards and controls in place. Like businesses, they might face complex legal problems for example around drawing up contracts, reviewing a trust deed or being involved in a commercial dispute. When deciding to instruct an external lawyer, the charity is likely to have in-house lawyers. The Charity Commission has provided guidance on what charity trustees need to know when thinking about taking or defending legal action generally. It is consistent therefore to exclude them from eligibility as we have large businesses. This focuses the Fund on those consumers of legal services that are less able to help themselves as is the case with other comparable schemes.
35. The risk and impact of money going missing is something that charities and trusts are expected to consider as part of their overall financial management arrangements. The Charity Commission's guidance on 'charity reserves: building resilience'⁷ sets out what a charity can do to demonstrate, amongst other things, the charity's resilience and capacity to manage risks and unforeseen financial difficulties to give confidence to funders by demonstrating good stewardship and active financial management. Trustees of large charities are often experienced professionals who are expected to publish, implement, and monitor their charity's reserves policy so they can comply with their legal duties.
36. We therefore would expect many larger charities and trusts to be able to bear the impact of loss of money caused by a solicitor or regulated law firm providing them with professional services or a stolen legacy.
37. They are also more likely to have the knowledge and resources to actively pursue other avenues of redress to recover any missing money. The charity or trust will be able to, for example, take legal action themselves to recover any missing money from the defaulting solicitor or firm. Insurance may also cover the loss. This change will not exclude a lay executor (as an individual) of a will that has left a legacy to a charity or trust from making an application for a grant from the Fund.

⁷ <https://www.gov.uk/government/publications/charities-and-reserves-cc19>

Prioritisation: limit claims to consumers of legal services and in certain circumstances the party on the other side of a legal matter

38. This change to our regulatory arrangements means that we will be limiting claims to people for whom the legal service has been provided and in certain circumstances the party on the other side of a legal matter.
39. This means that we are excluding applications from:
 - barristers and experts where a solicitor has received payment to cover the cost of professional services but the money is lost, and the barrister/expert is not paid.
 - businesses such as credit hire or vehicle repair companies used in personal injury matters where the solicitor has not paid their costs out of damages received because they have been lost.
40. We do not consider that a priority for the Fund is to substitute for normal business practices around payment of fees including debt recovery and claim for breach of contract processes where this becomes necessary. Barristers and other professionals are likely to be able to protect themselves through the commercial arrangements they agree with the solicitor/law firm. They are open to make choices on which solicitors/law firms they will engage with, and payment history may be a consideration in this. This is normal business practice. Businesses and experts that have been engaged by the solicitor on behalf the client will also be able to take steps to protect themselves through for example, tailored agreements or seeking payment in advance.
41. We have other protections in place which should help those that are providing their professional services to a law firms and solicitors for the benefit of a client. We expect these protections to be engaged during the event rather than the Fund being used after money has been lost. The SRA Code of Conduct makes it a requirement that solicitors (and law firms) must safeguard money that has been entrusted to them which might include money received for paying barristers, experts and others that provide services to them on behalf of their client. We would expect law firms to have systems and processes in place to help make sure that third party professional fees that become due will be paid.
42. Following feedback from the consultation we amended our consultation proposal to continue to allow claims that might be made from a party on the other side of a legal matter, where the solicitor has failed to use funds for the purpose intended to complete a transaction for their benefit, or to make a settlement or other payment to them. This may be, for example. where the solicitor is holding money in accordance with an undertaking given to them or their solicitor (as is common in conveyancing), or where the third party relied on the solicitor to transmit damages in a personal injury case. This amendment recognises that effective operation of the legal system requires mutual reliance and trust between solicitors on each side of a transaction or dispute.
43. As is the case now, and given that we operate the Fund as a fund of last resort, we would not make payments where we think that the applicant should explore an

alternative remedy, for example, against insurers or directly against the other party in the proceedings or transaction.

Prioritisation: conduct of the applicant

44. Our current rules provide that we may reduce or refuse a grant when an applicant's own actions contributed to, or they failed 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 lead to financial loss or while applying for a payment for the Fund.
45. We want to be more transparent and robust in the approach about how to take account the applicant's behaviour when assessing applications. To help clarify the circumstances when the conduct of an applicant may warrant refusal or reduction in a payment, we will publish information on our website. This information will cover, for example, where appropriate steps were not taken by the applicant to confirm that a high yield investment scheme was genuine and the solicitor's role in it was legitimate. This helps increase transparency in how we operate the Fund, as not all we do to inform our decisions is at present visible before someone considers making an application to the Fund.
46. The changes to our regulatory arrangements 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. We will also refuse or reduce a payment where the applicant has failed to pursue the application promptly, co-operatively and in good faith. We have not changed our rules which set out that an applicant must provide information, documents, and evidence that we request. This approach helps make sure that the Fund is not abused and that we have all evidence we need to understand the circumstances leading to the loss and assessing the merits of an application.

Prioritisation: being clearer about the circumstances where we make payments where insurance is not in place

47. Where a law firm should have held professional indemnity insurance in accordance with our rules but does not, then it is important that to make sure that consumers are protected. The SRA Code of Conduct for Solicitors, RELs and RFLs makes it clear that we expect all solicitors to make sure that clients understand the regulatory protections available to them. The Fund provides a safety net where an SRA authorised law firm should have had, but does not have, insurance in place. The rules confirming this position were approved by the Legal Services Board in May 2019⁸.
48. Further changes that we are now making will mean that we will not make grants arising from an insurer's insolvency, for example, where run-off policies have been disclaimed by a liquidator as part of the liquidation process. This is because there

⁸ https://www.legalservicesboard.org.uk/what_we_do/regulation/pdf/2019/20190531_Final_Decision_Notice.pdf

has been no default on the part of the law firm and the Fund should not have to step in to cover all circumstances.

49. If a regulated firm's insurer is insolvent, it is inevitable that some people that have a claim might need to engage with another person to progress it. Those that might have a claim in the future will need to consider the alternative avenues of redress that might be available. This will also depend on whether the administrators of the insolvent insurer decide to disclaim insurance policies or confirm that future claims will continue to be dealt with. The impact of an insurer becoming insolvent can impact law firms of any size.
50. Our experience is that where claims have already been notified to the insolvent insurer, the claim will continue to be managed by the appointed administrators. Often information is made available to persons with a claim confirming that they do not need to do anything. In cases where the appointed administrators are considering disclaiming live or run-off insurance policies, they will often make this known as soon as possible so that those considering making a claim do so.
51. Law firms that have paid premiums and persons that have a claim against that firm may seek redress from the Financial Services Compensation Scheme (FSCS) for example, if the affected firm meets the schemes eligibility criteria. If firms (or their clients) are not eligible to make a claim against the FSCS or against the insolvent insurer then we would expect for example, larger firms to be in a position to provide redress themselves or agree a settlement with the person asserting a claim.

Payments: maximum grant of £500,000 and how we 'define' a single claim

52. This change to our regulatory arrangements reduces the maximum payment for a grant from £2m to £500,000. We acknowledge that this may have a significant impact on the small number of eligible applicants who suffer losses above this amount. However, we consider this to be a fair and proportionate maximum payment level, which stacks up favourably against comparable schemes. We provide an analysis of these schemes in our supporting evidence and analysis (Annex 3).

Most payments from the Fund are relatively low - over the period 2010 to 2018 more than 75% of payments made were for less than £5,000.

53. We have explored the impacts on the level of consumer protection including for characteristically vulnerable people and on small firms. Our impact assessment sets out more detail, but our main findings are:
 - The maximum limit of £500,000 will provide full protection for the overwhelming majority of people: only 32 payments over the period 2004 - 2019 have been above £500,000 which is 0.2% of all payments.
 - Both the number of claims and the number of payments above £500,000 has been falling. This can mainly be attributed to the exclusion since 2015 of lenders and other large businesses from eligibility.
 - For conveyancing and probate which are the most common high value claims, the limits cover at 90% and 96% of all transactions respectively.

- That characteristically vulnerable applicants (older, lower social grading, BAME, disabled) are less likely to use the types of legal services that give rise to large claims on the Fund (conveyancing and probate).
 - The likelihood that small firms will be undertaking work that may involve very large sums of money that would not be covered by the £500,000 limit is low.
 - Comparative to other schemes, applicants will still receive a payment which covers most, if not all, of the loss suffered.
54. We also consider that if we are to enter a prolonged financial downturn, that history has shown can lead to more losses and claims on the Fund, this lower limit can help make sure that the Fund can provide a fair level of cover to most applicants while helping to manage the cost to the profession, which may ultimately be reflected in solicitors' fees and passed on to consumers.
55. We are maintaining our existing discretion to pay a higher sum in exceptional circumstances where we consider this to be in the public interest. The factors that we will consider will include:
- the impact of the loss on the claimant. We are more likely to find exceptional circumstances where the loss has a potentially catastrophic impact on the claimant's quality of life
 - the likely duration of such an impact – and the ability or otherwise of the applicant to “make up” losses by other means will be factors, and
 - the extent to which the wider public confidence in the administration of justice is impacted by the loss, for example if a person has already suffered an injury that impacts catastrophically on their quality of life, confidence could be undermined further if they also suffer any financial loss.
56. Given the lower limits, we have taken steps to set out a clear position about how we define a single claim for the purpose of deciding whether the maximum payment has been reached. We want an approach which is flexible enough to reflect factors such as the nature of the relationship between parties to the retainer (or those benefiting from the services provided in the case of beneficiaries).
57. In our first consultation we suggested that the general principle should be that where the loss of money relates to a single retainer, that should be dealt with as a single claim on the Fund. In light of the responses received we acknowledged that linking a single claim to a single retainer may lead to an unfair outcome in some circumstances. We therefore reconsulted on a proposal to apply the single claim limit to each individual applicant receiving payment.
58. We will apply the single claim limit to each individual applicant receiving payment. Each individual applicant will receive a maximum of £500,000 for the loss arising from a single event or set of circumstances. This would mean for example, where a separating couple has jointly instructed a solicitor to sell the family home that is worth significantly more than £500,000, and the sale proceeds are stolen, each person could make a claim for up to £500,000. This approach is flexible enough to reflect

factors such as the nature of the relationship between parties to the retainer (or those benefiting from the services provided in the case of beneficiaries).

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

59. This change to our regulatory arrangements introduces a new mechanism to allow us to manage the potential liability to the Fund from high value connected applications. The ability to cap claims provides an explicit mechanism to manage the potential liabilities faced by the Fund by the high value connected claims arising out of, for example, dubious investment schemes or an intervention into a large solicitors' practice. We have also warned solicitors and law firms about the risks of being involved in high risk investments and expect that the recent cases that have been considered by the Solicitors Disciplinary Tribunal will act as a deterrent.
60. The changes which cap payment levels are important to make sure that the Fund remains viable and will make it easier for us to be consistent in the level of contributions levied each year, providing greater certainty and ability to manage outgoings by those we regulate. The approach would still allow all eligible applicants to receive a reasonable level of redress, that compares favourably to other schemes with capping mechanisms. As outlined in our supporting evidence and analysis (Annex 3) several other compensation schemes apply mechanisms that aim to cap the liability for very large losses. We will cap payments:
- arising from a single or connected event, and
 - which are likely to exceed a specified financial threshold (£5m).
61. The most immediate application of this mechanism arises from solicitors' involvement in high risk investment schemes. The nature of the schemes and the way law firms operate in respect of these schemes is continually changing. In a recent case that was considered by the Solicitors Disciplinary Tribunal the solicitor acted on behalf of buyers to three 'fractional' development schemes, where purchasers paid deposits between 40-80% of the price for as-yet unbuilt units. The solicitor was lead partner in the sale of 118 units, for which almost £2.9m was deposited.
62. We have reviewed and refreshed the data that we hold and concluded that the £5m figure for the cap is proportionate, based on what we know about high value claims and the potential impact if we could not apply a cap on the level of contributions that would need to be collected from the profession. We think it less likely that the Fund will pay very large sums on one scheme because another regulator's fund has started to provide redress. However, there are potential liabilities in relation to new risks where we might expect high value applications to be made.
63. In our supporting evidence and analysis (Annex 3) we set out trends in contributions levels. Contribution levels have spiked after the last economic recession, and more recently as a result of the need to build reserves for potential high value losses arising from contentious schemes and most recently Covid-related risks. We estimate that each extra £10m of reserves or claims paid mean about an additional £35 on individual fee and £667 on firm fees.

64. This change places a finite cap for each scheme or event that could result in multiple high value losses. This will be a key factor in keeping contributions more stable and at as reasonable cost as possible for the profession. The risks that lead to claims on the Fund have and continue to change including the risk of a higher level of firm failure and claims as a result of the current unprecedented economic environment.
65. For the schemes where we are already making payments or where we assess we are likely to make payments our estimate of the value of claims arising for each of ranges from £1m to £10m with an average of £5m. We have not put more specific data in the public domain due to its confidential nature. We are already paying out for a failed scheme involving the sale of 'off plan' holiday homes abroad where we expect payments to be well in excess of the £5m limit we have set where we receive multiple applications arising from a single or connected event.
66. This means that going forward where we apply a cap, eligible applicants are likely to receive a payment to alleviate their financial loss, but the payment may be lower than they would receive now. The decisions will be case specific, depending the volume of claims that are connected and how the £5m is apportioned across the multiple applicants. Our expectation is that the approach would still allow all eligible applicants to receive a reasonable level of redress, that compares favourably to other schemes with capping mechanisms.
67. We will apply any of a number of options for apportioning the £5m between applicants depending on the nature of the issue. This approach gives us flexibility to consider and respond to the particular circumstances of the event to make sure we reach the fairest outcome.
68. We are making good progress in implementing new internal processes to apply the cap so that we are confident that we treat applicants consistently and fairly, communicating the outcome through all available mediums so that we are transparent.

Costs: exclusion of payments for litigation costs other than in exceptional circumstances

69. This change to our regulatory arrangements means that we will no longer make payments for litigation costs other than in exceptional circumstances. 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.
70. If our view is that an applicant is in a position to pursue litigation as an alternative means of redress and they incur litigation costs, then they may need to pay for these personally. We consider the position of the applicant on a case by case basis when considering what steps might be proportionate for them to take to recover losses elsewhere. For example, if they are well organised, resourced and/or sufficiently informed we would expect them to take more steps than a vulnerable person making an application on their own behalf.
71. If we have decided that the applicant has the means/resources to pursue litigation, we do not think the Fund should prioritise these payments. 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 other funding mechanisms such as contingency fee agreements that could be considered.

72. We may however, pay some litigation costs in exceptional circumstances.
- We may offer individuals choice to fund litigation upfront where there is another avenue of redress that they could pursue that means they might recover more than our limit. If they make this choice and receive a settlement below £500,000 they cannot then make a claim on the Fund, as they have been appropriately reimbursed according to the courts.
 - Where we think an applicant should pursue another remedy and they are funding the litigation, we may pay some reasonable costs, but only where not doing so would mean the applicant was in a substantially worse position than if we had processed the claimed straight away. We will apply the £500,000 limit to include these costs.

Costs: removing payments for costs associated with making an application to the Fund

73. This change to our regulatory arrangements means we will no longer make payments associated with the cost of making an application to the Fund.
74. The objective of this change is to make sure that we target the operation of the Fund on its core purpose of making good the direct financial loss caused by the actions of the solicitor or law firm. We do not think it should be necessary for applicants to seek professional help to make an application. We are therefore, making changes to how we help applicants to make an application to the Fund and that access to information on our website is easily accessible, and without the use of legal jargon that can sometimes be seen as a barrier. These changes are set out in our published documents and referenced in the table below.
75. We are working to make sure the application process is made as simple as possible and that applicants have the appropriate information available to help them through the application process. We will make sure that we deliver this additional support in a way that avoids any conflict of interest between SRA staff providing this support and the decision maker for whether the application is successful.
76. To help inform this work we are:
- gathering information from our operational teams, for example, the most frequently asked questions that applicants have.
 - planning to engage with applicants that have had a payment from the Fund which has included a payment for professional support in completing the application. We will explore why they felt it necessary to engage with a professional to complete their application, and take from that changes we think we can make so that the process is as straightforward as possible.

- continuing to explore with charities and other organisations that people may turn to for advice when they suffer a loss at the hands of a solicitor and how we can provide information and support to help them in helping applicants, especially those that are vulnerable.
- 77. We have made good progress with our business readiness and implementation work. We have completed a comprehensive review of information and support that is required to help people make an application to the Fund without the need for professional support.
- 78. We have produced new web content and a new application form and are ready to start testing this consumer organisations and the public through focus groups and development of a test web environment. We will use feedback to further refine this material. Alongside this we will now finalise the re-write of our decision making guidance to make it easier to understand and so consumers are clearer about the criteria and circumstance in which they are likely to receive a payment. This material explains how we make our decisions and the factors we consider when assessing applications for a payment from the Fund.
- 79. We have also been updating our internal processes to reflect the changes to provide more direct support to applicants as we process the claim, including to help them present the facts of the claim so we can then make a fair and robust decision.
- 80. We will be undertaking a full end-to-end testing of the complete package of information and support in March before we implement and deliver the training we have developed for staff.
- 81. Further details of the work we are doing is set out in paragraph 58-65 of our final impact assessment (Annex 4).

E. Rationale for amendments

- 82. Our objectives in reviewing how the Fund operates are to make sure:
 - we are clear about the purpose of the Fund, prioritising payments where they are most needed
 - we operate the Fund in a transparent way with decisions being made consistently and against clear, objective criteria, and
 - the Fund remains viable to continue to provide proportionate redress for the people it is there to protect and contributions from the profession are as manageable as possible.
- 83. During the consultation process it was evident that there was an on-going friction between:
 - the SRA's regulatory aim to provide proportionate consumer protection, prioritising the discretionary fund and managing its liability to make sure it remains viable at a fair and stable cost to the profession. This includes taking steps to control and manage the Fund's liability from high value claims

following the need to make some significant increases in contribution levels in recent years, and

- the majority view from respondents to both consultations that the Fund should meet every loss caused by a solicitor where there is no other redress available. And therefore, objecting to any change that would see a reduction in the protection that is currently available, both in terms of who is eligible to claim and the level of redress available.

84. In setting out our final decisions on the changes to how we operate the Fund. we were clear in our response to consultation that the Fund cannot be and was never "...intended or required to assume an open ended-ended liability to meet any unsatisfied loss by any party caused by the dishonesty of a solicitor..."⁹. The changes to the regulatory arrangements reflect regulatory best practice to allow us to take targeted prioritisation decisions. It is in the public interest for the Fund to remain viable at a proportionate and stable cost to the profession and able to protect future consumers of legal services.
85. In part because of the potential liability the Fund is carrying in relation to new risks, we have felt it necessary to raise the profession's contribution to the Fund in two of the last three years. Contributions from individual solicitors rose from £32 for 2016/17 to £40 for 2017/18 and then again to £90 for 2018/19. Firm contributions rose from £548 for 2016/17 to £748 for 2017/18 and then to £1,680 for 2018/19. Contributions dropped to £60 and £1,150 for 2019/20. One of the main reasons for the fall is an expected decline in the number and complexity of interventions (where we close down a firm to protect clients' interests). Contributions for the next practising year (2020/21) are set to fall to £50 for individual solicitors and for firms holding client money to £950.
86. It is important that we are clear and transparent about the purpose and operating principles of the scheme. We consulted on, and following feedback refined, a purpose statement (attached at Annex 5) to help people understand the circumstances when a claim is likely to be paid. This has an important role to play in promoting trust in the profession and regulated legal services.

F. Statement in respect of the Regulatory Objectives

87. The changes to our regulatory arrangements will have the following impacts on the regulatory objectives in s.1(1) of the Legal Services Act 2007.

RO1: Protecting and promoting the public interest	<ul style="list-style-type: none">• We have made changes to the Fund's scope and our prioritisation criteria to make sure that the Fund is viable for the future. The continuation of a Fund that is targeted to consumers of legal services that are least able to protect themselves is squarely in the public interest. If we see the anticipated effects of the economic downturn in the coming months
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⁹ R v Law Society ex p Mortgage Express [1997] 2 All ER 348, Lord Bingham CJ delivered the judgement to the Court

	<p>and years, we are likely to receive more applications to the Fund. The changes will make sure we can deal with those applications in a way that is fair and proportionate.</p> <ul style="list-style-type: none"> • Our changes clarify the purpose of the Fund. It cannot cover every conceivable loss caused by a solicitor. It is focused that on protecting consumers of legal services by helping those who have lost money due to fundamental ethical failures by those we regulate. This helps to uphold trust in the integrity of the legal profession. • We will continue to focus regulatory action on the solicitors involved in investment schemes and to provide information to the profession about the key signs of high risk or dubious investment schemes to reduce the risk they become unknowingly involved.
<p>RO2: Supporting the constitutional principles of the rule of law</p>	<ul style="list-style-type: none"> • Having a viable, consistent and transparent Fund helps maintain confidence in legal services. The Fund is a key consumer protection especially in situations where no other redress is available and will help those, for example individuals and small businesses that have suffered loss as a direct result of wrongdoing by their solicitor. • We will allow applications in certain circumstances from a party on the other side of a legal matter where the solicitor had failed to use funds for the purpose intended to complete a transaction for their benefit, or to make a settlement or other payment to them. This change was in response to consultation feedback recognising that the effective operation of the legal system requires mutual reliance and trust between solicitors on each side of a transaction or dispute.
<p>RO3: Improving access to justice</p>	<ul style="list-style-type: none"> • We have assessed the risk of whether the change will impact negatively on small firms and therefore on the supply of solicitors and think this is low. See our comments against R06 for more information.

	<ul style="list-style-type: none"> • Consumers may be more likely to access the services of a solicitor if they are confident that certain regulatory protections are in place, including access to a proportionate, fair and transparent Fund which will mitigate losses caused directly by dishonesty or unethical behavior from a solicitor.
<p>RO4: Protecting and promoting the interest of consumers</p>	<ul style="list-style-type: none"> • Our changes to eligibility mean the Fund is targeted to those that need most protection. The removal of hardship tests means we treat all applicants consistently, and there is a reduced burden for small businesses and charities to demonstrate they are eligible to claim. • In focusing on the viability of the Fund, we can make sure that consumers will continue to benefit from its existence in the future. • The lower maximum payment limit provides a proportionate level of protection when considered against both comparable schemes and the pattern and nature of past and expected payments – it will provide full protection for an overwhelming majority of eligible applicants that will be able to get most, if not all, of their money back. We have not identified a disproportionate impact on the reduced maximum payment limit on people with protected characteristics. • We are fair and transparent through our purpose statement and decision-making about how we prioritise payments from a limited Fund. This means consumers are better able to understand how they are protected by the Fund and the factors we consider when assessing applications for a payment from the Fund.
<p>RO5: Promoting competition in the provision of services</p>	<ul style="list-style-type: none"> • We maintain the cost of the Fund at as manageable cost to the profession as possible. This mean the regulatory burden on firms is proportionate, supporting a competitive market.
<p>RO6: Encouraging an independent,</p>	<ul style="list-style-type: none"> • We do not believe that the changes will negatively impact on this objective. We have reviewed the risk

<p>strong, diverse and effective legal profession</p>	<p>that the proposals could have a negative impact on small firms (and therefore older and BAME solicitors that are overrepresented in small firms) and think the risk is low. If the Fund is to remain viable to provide a proportionate and targeted level of protection in the future, we believe that the changes we are making are necessary.</p> <ul style="list-style-type: none"> • Our view is that overall, these benefits outweigh the low risk of potential negative impacts for solicitors from protected groups, or risk to the supply of solicitors from these groups.
<p>RO7: Increasing public understanding of the citizen’s legal rights and duties</p>	<ul style="list-style-type: none"> • Our purpose statement helps people to better understand the scope of the Fund, whether they meet the criteria to make an application to the Fund. • We will provide information to explain how we make our decisions and the factors we consider when assessing applications for a payment from the Fund. We will test this with focus groups, so it is written in as consumer friendly way as possible. • We will provide information to the public so they are clearer about where their contributory conduct or behavior may warrant refusal or reduction of a payment should they make an application to the Fund. This will help people to better understand how they are protected when they use a solicitor. We will also update our information to ensure consumers understand what is required of an application to the Fund.
<p>RO8: Promoting and maintaining adherence to the professional principles</p>	<ul style="list-style-type: none"> • We consider the changes to have a neutral effect on this regulatory objective.

G. Statement in respect of the Better Regulation Principles

88. In making changes to our regulatory arrangements, we have fulfilled our obligation under section 28 of the Legal Services Act 2007 to have regard to the Better Regulation Principles, as follows.

<p>Proportionate</p>	<ul style="list-style-type: none"> • The changes provide a proportionate level of consumer protection, allowing us to prioritise payments transparently and fairly and to make sure the Fund remains viable in the future. (see also comments under RO4 in the statement above). • We believe our changes are proportionate and targeted to the risks and issues we have identified. We have responded to the concerns raised in the feedback to the consultation about the impacts of the changes including on equality, diversity, and inclusion. This is set out in our final impact assessment. • The changes are designed to makes sure that contributions from the profession are as manageable as possible and so do not place disproportionate regulatory costs on solicitors or groups of solicitors. This is especially important given the current economic climate.
<p>Accountable</p>	<ul style="list-style-type: none"> • The changes clarify the purpose of the Fund. We have engaged with a wide range of stakeholders throughout including public consultation and focus groups with consumers. • Our purpose statement sets out when and how we will make payments from the Fund so that both solicitors and consumers can understand how it operates.
<p>Consistent</p>	<ul style="list-style-type: none"> • Our changes to who can make an application to the Fund help make sure that we adopt a consistent approach to eligibility and treat all applicants equally. • Clearer rules will support consistency of decision making against clear and objective criteria in a way that can be understood. • The changes, as a complete package of reforms, will also make it easier for us to be consistent in the level of contributions levied each year, providing greater certainty to those we regulate.

Transparent	<ul style="list-style-type: none"> • We will publish information, for example, when we consider it necessary to cap payments. This will lead to greater transparency and help engagement with consumers. • Changes to how we support applicants including an easier to use application form will make it clear early in the process what needs to be submitted to make a 'good' application.
Targeted	<ul style="list-style-type: none"> • The changes are targeted to make sure that only those consumers that need to protecting have access to a well-run and viable Fund. • The changes to the scope of what is covered by the Fund target its operation on its core purpose of making good the direct financial loss caused by the actions of the solicitor or law firm.

H. Statement in relation to desired outcomes

89. Section 36 (2) of the Solicitors Act 1974 makes provision for rules to be made which set out the circumstances in which grants may and may not be made from the Fund. We want to make sure that we have in place a regulatory framework which is proportionate and targeted and contains only those regulations and processes that benefit the public interest. The chief impact of the misuse and misappropriation of money is upon those persons whose money has been misused, although such activities will also harm public confidence in the legal market and solicitors. This can crystallise as an actual loss of money, requiring remedy from the Fund.
90. The Fund is, therefore, a key consumer protection for people accessing regulated legal services, because it is available to people with no other avenue of redress. But it is important to remember it is also a discretionary fund, it is financed by the profession, and we therefore need to make sure we prioritise payments fairly and transparently. Our reforms make sure we are fair and consistent in our approach, and transparent about how we prioritise payments from a finite fund and at a proportionate cost to the profession.
91. Our view is that the level of consumer protection provided is proportionate when considered against other comparable schemes and the pattern and nature of past and expected payments – the Fund will provide full protection for an overwhelming majority of eligible applicants. We provided an analysis of other schemes in our first consultation¹⁰.

¹⁰ <https://www.sra.org.uk/globalassets/documents/sra/consultations/supporting-evidence-analysis-comp-fund.pdf?version=48f268>

92. We want to be fair and transparent through our purpose statement, information for applicants, and decision-making about how we prioritise payments from a limited fund. This means consumers will be better able to understand how they are protected by the Fund, and it remains viable in the future with contributions from the profession as manageable as possible.
93. More manageable contributions will be of particular benefit to small law firms and recognised sole practitioners who have less financial resilience to manage the impact of increased and unpredictable contributions. More than half the firms we regulate meet our definition of a small firm. This will benefit BAME and older lawyers who are more highly represented amongst lawyers practising in small firms.
94. The Fund is targeted at consumers of legal services (and in certain circumstances the party on the other side of a legal matter), that are least able to protect themselves. The removal of hardship tests means we treat all applicants consistently and there is a reduced burden for small businesses and charities to demonstrate they are eligible to claim.
95. There will be some applicants such as large charities and trusts and third parties such as barristers and expert witnesses who will no longer be eligible to make a claim on the Fund. These changes recognise that these individuals and organisations are better able to protect themselves against the risk of losing money when engaging with a solicitor or law firm and to take action to recover any losses, but also that the Fund should be there for those consumers that need help the most.
96. Some individuals will need to provide us with evidence of the impact of their loss because we may refuse claims when we consider the loss to be disproportionately low or appropriately compensated elsewhere. The evidence on the financial resilience of most UK households suggests that we will use this discretion in very rare circumstances because losses would likely be material to most applicants.
97. People that lose money in circumstances where claims are connected and collectively amount to £5m will continue to receive a level of compensation, but payments will be capped. Our assessment is that this is proportionate to make sure the Fund remains viable, providing redress for those it is there to protect and keeping contributions from the profession as manageable as possible. We will continually review the £5m cap to take into account any changes in the pattern and value of applications to the Fund.
98. The evaluation framework that has been developed for our Looking to the Future reforms will be used as a guide to develop indicators to evaluate the impacts of changes to the Fund.
99. We will therefore monitor who the Fund is paying and the risks in the market that give rise to claims on the Fund, to help us assess that we are achieving our aims that the Fund is targeted at those that need protecting, that we are prioritising payments in a transparent and fair way and that it provides proportionate protection at as manageable as possible cost to the profession.
100. We have said that we will include in the application form, a data request for information that will help us monitor any impact on people with protected

characteristics applying to the Fund. We will also monitor any impact on small firms. In both cases, if either of these is unintended consequences materialise, we will consider any action we need to take.

101. Aligned to the approach we are taking to evaluate our other reforms, we will look at the impact of these changes at the one, three and five-year point.

I. Stakeholder engagement

102. In our first consultation in 2018 we stated that the Fund should not guarantee that all users of legal services will be covered for any financial loss caused by a solicitor or law firm. We also set out a general position that we considered the Fund should be a hardship fund, protecting the vulnerable that would need and deserve it most. We proposed changes to:

- our eligibility criteria including a wealth-based criterion for individuals
- narrow the type and level of payment made by the Fund, and
- strengthen how we take account of the behaviour of the applicant in deciding whether to make a payment to them

103. There were 160 responses from representatives of consumers, members of the public, representatives of the profession, individual solicitors, law firms of different types and others. We published a summary of responses in January 2020 alongside our second consultation. The consultation revealed a divergent understanding of the, and views about, the purpose of the Fund and the circumstances in which peoples should be able to benefit from it. Both consultations revealed an ongoing friction between the SRA's regulatory aim to provide proportionate consumer protection and the majority view from respondents that the Fund should meet every loss caused by a solicitor where there is no other redress available.

104. Having considered the views put forward, we reviewed the purpose of the Fund from first principles and developed a purpose statement and revised set of proposals for a second consultation. This included progressing some of the proposals from the first consultation.

105. We suggested revised proposals in three main areas.

- Defining and articulating the purpose and operating principles of the Fund.
- The eligibility criteria for applicants.
- Developing an approach and methodology for managing the liability presented by high value, multiple applications arising from for example, solicitor involvement in dubious investment schemes.

106. We received fifteen responses to our second consultation. We received the most responses from representative bodies such as the Law Society and local law societies. The Legal Services Consumer Panel (LSCP), the Legal Ombudsman and other representative groups were among the other respondents.

107. As well as seeking formal responses to the consultation, we undertook targeted engagement to discuss the proposals and what the impact on certain groups might

be. This involved speaking at events and meeting with key stakeholders that have an interest in our financial protection arrangements.

108. We also held a small number of consumer focus groups to seek direct views on our proposals. We will continue to work with stakeholders as we implement changes.

Further Feedback

109. While some of the responses expressed mixed views about our proposals, there was in principle support for the following:

- setting out more clearly the purpose of the Fund
- a consistent approach to eligibility without reference to a hardship test beyond a discretion to refuse or reduce a payment where the impact of the loss on the applicant is immaterial, and
- a capping mechanism to manage the impact on the viability of the Fund when we receive connected high-value applications, while making sure we treat applicants fairly and ensuring they receive some level of redress.

110. There were different views about the detail of the above and how some of the proposals might work in practice. Some respondents also took the opportunity to reiterate their objections and provide further feedback on the proposals that we said we were progressing following the first consultation.

111. In its response to the second consultation the Law Society reviewed the proposals against the regulatory objectives and said it was broadly supportive of the intentions of the review. It set out some concerns about the specific means by which we said these would be delivered.

112. The LSCP, while agreeing that it was right to re-assess the Compensation Fund arrangements including the need for the Fund to be sustainable, thought the proposals placed too much risk on the consumers of legal services. It considered the proposals to be poorly designed in some respects due, in its view, to a weak evidence base and a lack of consumer research or quantified impacts. It was strongly opposed to the new prioritisation criteria that would limit claims to direct recipients of legal services.

113. In addition, the LSCP and the Law Society discussed in their responses whether there was more to be done to reduce the cost of running the Fund. They questioned whether intervention costs should be paid out of the Fund, and if they are, whether they could be reduced. They also asked whether more should be done to tackle the root causes that result in people suffering a financial loss as a result of a solicitor's poor conduct. They suggested this could make it unnecessary to make changes to narrow payments from the Fund.

Final changes

114. Having considered the consultation feedback and reviewed the potential impacts we amended our proposal which would have limited claims to people that have been provided the legal service. Nearly all respondents strongly opposed this proposal. We proceeded with all the other proposals. We have reviewed the responses from the

consultation and remain of the view that the proposed arrangements provide a proportionate level of consumer protection, allow us to prioritise payments transparently and fairly and to make sure the Fund remains viable in the future. The table provides a highly level summary of how we responded to feedback received during the consultations and references to the sections in other published documents to the detailed feedback.

Final change	Stakeholder feedback	Further detail
<p>Purpose and operating principles</p>	<p>Several respondents including the Law Society, local law societies and from law firms objected to the proposal of defining the Fund as a hardship fund, some suggesting in line with the view taken by the Law Society that this was not an option open to us.</p> <p>Having considered the feedback from the first consultation, we thought again about the Fund's purpose and how it could be focused tightly on losses to consumers of legal services caused directly by the ethical failures of solicitors and law firms providing them services. This means that the Fund would not try and cover all circumstances where a consumer may otherwise suffer a financial loss</p> <p>We developed a statement to try and articulate the purpose of the Fund and in the further consultation asked for views on whether it would help people understand the circumstances when a claim is likely to be paid.</p> <p>There was a clear consensus that such a statement was useful. We have taken into account some style and drafting comments and published an updated version that reflects the final changes.</p>	<p>Annex 6(i): paragraph 1 to 6 paragraph 26 to 31 Annex 5: Purpose Statement</p>
<p>Eligibility to Claim:</p> <p>Focus on individuals, small businesses, small charities and trusts</p>	<p>We received very strong objections to proposed eligibility criteria that would have seen the Fund more narrowly purposed as a hardship fund.</p> <p>There was particular objection to the proposal to exclude applications from 'wealthy individuals' from eligibility on the grounds that this may create an arbitrary and unfair limit.</p> <p>We were persuaded by feedback to the first consultation and consulted further on revised eligibility criteria that removed any financial or hardship tests for tests for individuals, small businesses, small charities and small trusts.</p> <p>There was unanimous support for the removal of hardship tests. The common theme from responses was that any loss of money would have an impact on</p>	<p>Annex 6(i): paragraphs 32 to 48</p>

	<p>eligible applicants and that the requirement to demonstrate hardship was unnecessary.</p> <p>There was also strong support for the proposal about using residual discretions to refuse or reduce payments when we consider the loss to be immaterial or substantively compensated elsewhere.</p> <p>The feedback was that the use of discretion in this way aligned with the statutory purpose of the Fund. The Law Society thought this was not unreasonable, especially if information as to the factors that might lead to such a decision and explaining in practice how the discretion is likely to be exercised was to be issued. We have set a general expectation that the cases where we would use this discretion would be rare, because most losses will material particularly when taken in the context that evidence that of the level of savings of UK workers.</p> <p>The Law Society provided a suggestion in its response that we might want to introduce a de minimis payment amount and this might save administrative costs. We provided analysis that shows that to reach the volume of claims that would have a material impact on the administration cost of the Fund, a minimum payment amount would need to be set at a level we think that people might not be able to afford to lose.</p>	
<p>Eligibility to Claim:</p> <p>To exclude large charities and trusts with income/ assets of more than £2 million</p>	<p>We had feedback that our proposal to exclude large charities and trusts could mean that deserving beneficiaries with no other means of redress would be impacted. The Law Society's response raised concerns about the existing use of hardwired eligibility criteria linked to the wealth of businesses.</p> <p>We remain of the view that large charities and trusts should be subject to the same eligibility criteria as large businesses because they can take steps to better manage the risks of using legal service that individuals and small businesses.</p> <p>Large charities and trusts, like businesses, will often face complex legal problems. When deciding to instruct an external lawyer, the charity is likely to have in-house lawyers. The Charity Commission has provided guidance on what charity trustees need to know when thinking about taking or defending legal action generally, and when the Charity Commission needs to be involved. Trustees of a large or complex trust are also likely to seek professional advice on</p>	<p>Annex 6(ii): paragraph 5 to 15</p>

	<p>how they should comply with their obligations and how the trust should be managed</p> <p>A large charity is also likely to possess the expertise necessary to put in place, monitor and review a reserve policy that builds the financial resilience to manage the risk and or impact of missing legacy donations, and have the resources and know how to seek to recover these losses in other ways where possible.</p> <p>On balance we think there are strong rationale for the Fund to prioritise payments in this way</p>	
<p>Eligibility to claims</p> <p>Limit claims to consumers of legal services and in certain circumstances the party on the other side of a legal matter</p>	<p>After thinking hard about purpose of the Fund we consulted on limiting claims from those for whom the legal service is being or had been provided. Beneficiaries and others who are not under client retainers but are receiving the legal service in question would remain within scope. However, as well as third parties such as barristers and experts this would have excluded claims from other parties on ‘the other side’ of the legal transaction such as buyers who have lost money because of the dishonesty of their seller’s solicitor in a conveyancing transaction.</p> <p>We received very strong opposition to this proposal, in particular from the LSCP. We have considered the feedback we received and decided to amend this proposal to allow claims from non-clients in certain circumstances. This amendment recognises that effective operation of the legal system requires mutual reliance and trust between solicitors on each side of a transaction or dispute.</p> <p>We also had feedback, including from the Bar Council, that we should not exclude applications from barristers and other third-party experts for unpaid fees because paying these claims respondents helps maintain trust in the profession. We decided to proceed with this proposal because our view is that where the third party is an expert or a professional themselves, they are more likely to be able to protect themselves in their commercial arrangements with the solicitor in the first place. If something does go wrong they are likely to have the skills to pursue other routes of redress, such as the debt recovery process. We do not think that the Fund should be used as a substitute for debt recovery or claim for breach of contract processes.</p>	<p>See Annex 6(i) paragraphs 49 to 63</p>

<p>Reduction in the maximum payment from £2m to £500,000</p>	<p>There was little support for the proposal to reduce the level of the maximum pay out to £500,000. This was mainly on the grounds that it would reduce consumer protection from the current level.</p> <p>For example, both LSCP and the Law Society were in strong opposition to this change arguing that given the low numbers of people affected the resulting reduction in the liabilities of the Fund would be limited.</p> <p>In response to comments received about the reduction in the maximum grant payable, we have updated our data on impacts and explored the issue raised about potential impacts on small firms and those that use them.</p> <p>As a result of this additional analysis, we are satisfied that this is this a fair and proportionate maximum payment level, which compares favourably against comparable schemes including those of other legal services regulators and for other professional services. We have also given examples of the situations where we may pay a higher limit ‘in exceptional circumstances’.</p>	<p>Annex 6(ii): paragraph 16 to 26</p> <p>Annex 4: paragraph 39 to 44</p>
<p>Capping mechanism to cap payments:</p>	<p>We received feedback that it would be beneficial to take steps to protect the viability of the Fund and provide stability around the level of contributions.</p> <p>This included that our changes should focus more squarely on addressing the threat posed by solicitor involvement in dubious investment schemes. This was because we presented this as the main threat to the sustainability of the Fund at a proportionate cost to the profession. Several respondents said that they could see the benefit in having tools to limit the amount that is paid out in relation to these types of schemes.</p> <p>We consulted on a proposal to cap payments arising from a single or connected event, and which are likely to exceed a specified financial threshold.</p> <p>There was a mixed response about this proposal. The majority agreed that in principle a capping mechanism could be beneficial and necessary. Some of these respondents however expressed concerns with how we said we would apply the cap in practice.</p> <p>We explored the detailed feedback that we had about the level of the cap and how we would apportion between applicants in our response</p>	<p>Annex 6(i): paragraph 71 to 86</p> <p>Annex 4: paragraph 45 to 52</p>

	<p>document. We remain of the view that setting a fixed-level cap is the fairest and most transparent option, and that the £5 million figure is right, based on what we know about high-value claims and the potential impact on contributions. We have also decided to maintain the flexibility to apply any of a number of options for apportioning the £5m between applicants depending on the nature of the issue. This approach enables us to consider and respond to the particular circumstances of the event to make sure we reach the fairest outcome.</p>	
<p>Excluding application costs</p>	<p>We had feedback, including from the Law Society and LSCP, that the change to no longer pay for people to get professional help with applying for a grant from the Fund would impact on vulnerable consumers, especially at a times when free advice services and support is dwindling and overstretched.</p> <p>Our approach will be to help the applicant to present the facts that we need to make a fair and robust decision so that this type of additional support will not be needed.</p> <p>We remain of the view that the Fund should be focused on providing redress for direct financial losses and it should not be necessary to seek professional help to apply to the Fund.</p> <p>Our view is that the steps we have set out in paragraphs 58-65 of our final impact assessment (Annex 4) will help make the application process as straightforward as possible. We will continue to make improvements so that the applicants, and particularly, vulnerable applicants, are confident in engaging with the SRA.</p>	<p>Annex 4: paragraph 58 to 65</p>
<p>To pay litigation costs in exceptional circumstances</p>	<p>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, we proposed to exclude litigation costs completely.</p> <p>We explained in the rationale supporting this change that we already factor individual applicants' ability to pursue other avenues of redress in deciding whether this is realistic for them or we should proceed to process their claim. We do not expect most individuals to pursue other redress which have high costs, particularly given that payment from the Fund might be low relative to those costs.</p>	<p>Annex 6(ii): paragraph 39 to 43</p>

	<p>However, following feedback about the impact this might have on an applicants' ability to pursue alternative means of redress, we amended our proposal that these would be paid in exceptional circumstances, proportionate to the nature of the application.</p>	
<p>Conduct and behaviour of the applicant</p>	<p>Our changes will mean that we take a more robust approach to how we take into account the conduct and behaviour of the applicant.</p> <p>This had some support with suggestions about the steps that a potential investor/client might be expected to take to investigate whether a scheme or transaction was genuine. This feedback will help inform information we publish for applicants.</p>	<p>See consultation paper: paragraph 54 to 64</p>
<p>Not pay grants where an insurer has become insolvent</p>	<p>This change was not supported, and we had feedback that this would lower consumer protection particularly for clients of larger firms.</p> <p>Our view remains that this is not a loss caused by an ethical failure of a solicitor and the Fund should not be a last resort for any financial loss suffered by the client of a solicitor. We will continue to discuss with the Financial Conduct Authority whether there may be changes to FSCS for consumers of large law firms to be able to claim on their scheme when an insurer becomes insolvent</p>	<p>Annex 6(ii): paragraph 44 to 48</p>
<p>Data and Impacts</p>	<p>Several respondents including the LSCP asked for further data about applications to and payments made from the Fund, to better understand the impact of the proposals.</p> <p>Many respondents expressed concerns about the impact of some of the proposed reforms. For example, the Law Society thinks the proposals could risk inadvertently undermining equality, diversity and inclusion.</p> <p>In response we updated our evidence base and explored these concerns in our response document and in more detail in the impact assessment published alongside this report.</p>	<p>Annex 4</p>

J. Statement in relation to impact on other Approved Regulators

115. We do not believe our proposals give rise to any conflict between any of the approved regulators.

K. Implementation

116. This is our planned timetable for implementation.

Action	Date
Submission to LSB	January 2021
LSB approval	April 2021
Implementation	We are aiming for the rules to be approved ahead of the next contribution setting, and to come into force after the roll out of our new case management IT system which includes some new functionality to support the new rules. We are making good progress with the detailed work to make the changes required to our systems and business processes to implement the reforms.

L. Evaluation

117. The evaluation framework that has been developed for our other reforms will be adapted to consider and review the impacts of this key element of our reform programme. This has been successfully used to evaluate our price transparency rules, but may need some adaptation to reflect the purpose and effect of the Compensation Fund rules.
118. We will be focusing on assessing the impact on regulated providers, consumers and the wider legal services market including the impact on equality, diversity and inclusion, especially in relation to the impact on applicants of the new maximum payment limit and our ability to cap payments arising from connected events. We will also monitor that the changes are not having a detrimental impact on smaller firms. We will do this undertaking consumer and market surveys and continuing to monitor the value and type of work undertaken by smaller firms.
119. A key measure will be whether the changes have succeeded in making the scope of consumer protection clearer to consumers upfront, and that we have reduced consumers' expectations where they are likely to not be paid.
120. We will also develop our approach to evaluating the effectiveness of the steps we have taken to help applicants make a claim without the need for professional help.
121. To make sure that our arrangements remain proportionate we will continue to review how we operate the Fund against comparable schemes and whether there has been any impact on contributions the profession make to the Fund. We will make an initial evaluation one year after they have been fully implemented and then again after three years.

M. SRA Contact

122. If the LSB has any queries in relation to this application please contact:

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Annexes

Annex 1: SRA Compensation Fund Rules 2020
Annex 2(i): SRA Board paper (14 July 2020)
Annex 2(ii): SRA Board paper annex (14 July 2020)
Annex 3: Supporting evidence and analysis published with July 2020 consultation
Annex 4: SRA final impact assessment
Annex 5: Compensation Fund Purpose Statement
Annex 6(i): Summary of responses and SRA response to consultation
Annex 6 (ii): Annex 1 to Summary of responses and SRA response to consultation