Protecting users of legal services - prioritising payments from the SRA Compensation Fund: Consultation

January 2020

Contents

About this consultation

1. This consultation sets out proposals for reforming our Compensation Fund arrangements.

2. This follows the conclusion of a consultation last year which proposed reform to both our Professional Indemnity Insurance (PII) and our Compensation Fund arrangements. We received 160 responses to that consultation, which we have considered carefully in developing our next steps.

3. We have decided not to proceed with the substantive PII proposals at this time. We published a document setting out this position and our reasoning for it in December 2019.

4. Having reflected on the views expressed in relation to our Compensation Fund proposals, we have decided to:

    - proceed with some proposals and

    - in other areas, to consult on a revised set of proposals.

5. The revised proposals are set out in this document. An overview of responses to our earlier Compensation Fund proposals can be found on page 11 later in this document. You can also read a fuller summary of responses.

6. We have published draft rules that take into account the decisions from the previous consultation that could affect the new proposals in this one. We have provided evidence and analysis to support these proposals.

7. We are keen to hear your views on the revised proposals that we set out in section three and the accompanying questions. This consultation is running from 21 January to 21 April.

8. After this consultation closes, our next steps will be to collate and analyse all the responses. We will then decide which of the proposals to take forward and make revised rules accordingly.

How to respond

Our online questionnaire

Our online consultation questionnaire is a convenient way to respond. You can save a partial response online and complete it later. You can also download a copy of your response before you submit it. Online responses in a standard format help us with accurate and quantitative analysis.

Start your online response now - https://form.sra.org.uk/s3/comp-fund-reform-2020

Reasonable adjustment requests and questions

We offer reasonable adjustments.

Contact us - protectreforms2020@sra.org.uk if you need to respond to this consultation using a different format or if you have any questions about the consultation.

Publishing responses

We will publish and attribute your response unless you request otherwise.

Section 1: Background to consultation

Why are we considering a change?

1. We operate a Compensation Fund (the Fund) that can make payments to people who have suffered a financial loss because of the dishonesty of somebody that we regulate, or because they have failed to account for client money that they received. The Fund can also make payments because somebody we regulate is unable to make good a loss for which it is liable because they have not taken out the insurance that we require. The Fund also pays the costs associated with us intervening into a solicitor practice in order to protect clients and their money.

2. Completing our review of our Fund arrangements is the final strand of our Looking to the Future regulatory reform programme. This programme has fundamentally reviewed both our approach to regulation and our regulatory arrangements to ensure that they are up to date and fit for purpose.

3. The Fund has been operating for nearly 70 years, with no substantive review for around 20 years. We have made only piecemeal changes to how the Fund operates. Our reform programme provides the opportunity to take a fresh look at our policy and rules in this area. We want to make sure that we are managing the Fund in as effective a way as possible in light of its statutory purpose, our regulatory objectives and best regulatory practice. A review was therefore timely.

To enhance consumer protection

4. The Fund is a key consumer protection. In situations where no other redress is available, it can potentially compensate people who have suffered loss as a result of wrongdoing by regulated legal professionals. However, the Fund is discretionary and is financed by the profession. Its costs are ultimately reflected in the price of services. It is therefore important that our policy and rules in this area make sure:

    - funds are prioritised and are focused where they are most needed
    - the Fund has a clear purpose and priorities
    - the Fund is operated in a transparent way with decisions being made consistently and against clear, objective criteria.

5. This will help consumers understand the protection provided by the Fund.

Proportionate cost for the profession

6. It is also important that we maintain the Fund at a proportionate and stable cost to the profession, given the changing market, consumer behaviour and risks that give rise to applications against the Fund.

7. These changing risks currently include a rise in high value and multiple, connected, applications including from solicitor involvement in large scale dubious investment schemes. This specific risk has resulted in warnings to the profession and the public setting out our concerns and expectations.

8. In part because of the potential liability the Fund is carrying in relation to these 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). Read our evidence and analysis for further detail.

9. Against this backdrop, we concluded a consultation last year on a package of reforms to the Fund designed to address these issues. We have listened to the views and insight set out in the 160 consultation responses received. We have also looked at how comparable schemes operate. We remain of the view that reform is needed for the reasons set out above relating to consumer protection, effective regulation, sustainability and cost efficiency for the profession.

10. We are progressing with some of the proposals that we previously consulted on. We set out details in the next section of this document. They include:

    - taking steps to more closely target to financial loss caused directly by the actions of those we regulate
    - reducing the maximum payment for a grant
    - no longer covering the unpaid fees of barristers and other professional experts
    - clarifying our expectations around the conduct and behaviour of applicants

11. However, we are also proposing to revise our approach in key areas in light of the responses received to our earlier consultation and our further thinking. We set out further details in section three of this document. These areas include:

    - how we articulate the purpose of the Fund
    - our eligibility criteria for applications against the Fund
    - tools to manage the potential liability presented by high value, connected applications.

12. We invite and welcome your views on these new proposals.

13. The remainder of this document sets out:

- a summary of how the Fund currently operates
- a summary of our previous consultation
- an overview of responses to that consultation
- details of the previous proposals that we will be taking forward
- details of new proposals that we are now consulting on

How does the Fund work now?

Purpose

14. The Fund primarily helps people:

- who have suffered financial loss due to the dishonesty of a regulated person or firm
- who have suffered hardship due to a regulated person a firms' failure to account for money they received[1]
- who have suffered financial loss because of the actions of a regulated person or firm who should have been insured under our rules but was not[2]

Eligibility and hardship criteria

15. The criteria defining who is eligible to apply for a grant from the Fund is set out in our decision making guidance and are summarised in the table below. They vary depending on who the applicant is (ie 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

[1] This includes failure by a regulated person or firm to finish work for which they have been paid
[2] Meaning a qualifying insurance policy under our Minimum Terms and Conditions

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

16. The current rules are wide in scope. Eligible applications are not limited to losses incurred by the client of the firm (for example, barristers can make a claim for unpaid fees and somebody buying a house can claim against money lost by the seller's solicitor). The Fund can also be used for the cost of seeking help to complete an application or for pursuing other legal remedies to try and recover losses eg in proceedings against a firm.

The Fund's discretionary nature

17. Every eligible application is considered on its merits. In deciding whether to make a grant we consider a range of factors (set out in our rules), including whether:

    - the loss can be made good by some other means
    - activities, omissions or behaviour of the applicant contributed to their loss
    - the loss results from the combined activities of more than one party (e.g. a solicitor and a surveyor) and so should be apportioned.

18. For applications brought on grounds of dishonesty and failure to account, we will only consider paying out if the activity was of a kind which is part of the usual course of a regulated person's legal business. Where the claim is brought because of an uninsured loss we will only consider paying if our PII requirements require a policy that would have covered the cause of the loss.

19. Notwithstanding the above criteria, our rules and the caselaw that has considered how the Fund operates make it clear that a grant from the Fund is made wholly at the discretion of the SRA and that no person has an enforceable right to a grant. This gives rise to a residual discretion about whether to make grants.

Section two: Our previous consultation

Our proposals

20. In our 2018 consultation we stated that the Fund should not guarantee all users of legal services will be covered for any financial loss caused by a solicitor or law firm. We 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. A summary of our 2018 proposals is set out below.

Eligibility to claim

21. We proposed that we should:

- exclude applications from individuals with net household financial assets above a threshold of £250,000 (with no hardship test for those below this threshold)
- exclude large charities and trusts with an income or assets of over £2m, while maintaining the discretion to deal with applications where it can be demonstrated that individual beneficiaries would suffer hardship
- simplify the tests we use to assess whether a payment should be made so that all eligible businesses, charities and trusts must show hardship in all three categories of claim (dishonesty, failure to account and a law firm not being insured)
- exclude applications for grants of unpaid fees from barristers and other experts.

Type and level of payments made by the Fund

22. We proposed that we should:

- limit payments for eligible applicants to the direct financial losses caused by the actions of the solicitor (excluding application costs and litigation costs)
- tighten up the circumstances when we make a payment where an SRA authorised firm has failed to get the required insurance
- exclude applications arising from an insurer's insolvency eg where run off policies have been disclaimed by the liquidator

- reduce the maximum payment per claim from £2m to £500,000 with the ability to consider making a higher payment in exceptional circumstances

- provide ourselves a wide discretion to refuse or limit payments of grants in particular circumstances, or in relation to particular types of application, applicant or loss (therefore allowing us to explicitly exclude or cap eg dubious investment schemes).

The conduct or behaviour of an applicant

23. We proposed that we should:

    - apply a clearer and more robust approach to how we take account of the applicant's behaviour when assessing applications

    - require a duty of full and frank disclosure by an applicant.

24. We asked for views about whether setting out guiding principles could make the purpose and the scope of the Fund and how we make decisions clearer.

What did people say?

25. We set out an overview of some of the key themes from the consultation responses below.

Purpose of the Fund

26. There were mixed views about whether the purpose of the Fund and the way that we operate it is clear at the moment. Most respondents who answered the question said that they supported the idea of introducing guiding principles as it would aid understanding and transparency of how the Fund operated.

27. A number of respondents accepted that it would be beneficial to take steps to protect the viability of the Fund and provide stability around the level of contributions. However, this was rarely followed by support for our specific proposals for doing so.

28. 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.

Scope of payments

29. Several respondents argued that as the Fund was discretionary, we did not need to redefine the purpose of the Fund or introduce changes to eligibility to maintain the viability of the Fund.

30. Many respondents, particularly from the profession, argued that a core principle of the Fund is that people should receive redress if their loss is the direct result of the actions of a solicitor and there is no other redress

available. This is so that trust in the profession as a whole is upheld. Therefore, there should not be additional eligibility tests, or any narrowing of the type and levels of payment made by the Fund.

31. There were objections from a wide range of respondents to the proposal to exclude applications from 'wealthy individuals' on the grounds that this may create an arbitrary and unfair limit. Such a limit could leave some individuals out of pocket irrespective of the impact of their loss. Some highlighted that this type of threshold criterion may be resource intensive and difficult to administer in practice.

32. Some respondents also thought that our proposal to exclude large charities and trusts could mean that deserving beneficiaries with no other means of redress would be impacted.

33. Some respondents including the Bar Council questioned our proposal to exclude payment of barrister and expert fees, particularly where the loss may cause hardship. This view was often linked to the broader argument that trust in the solicitor's profession required the widest possible access to the Fund.

Payment limits

34. There was little support for the proposal to reduce the level of the maximum pay out to £500k. This was mainly on the grounds that it would reduce consumer protection. Several respondents also argued that there would be difficulties in determining fairly what constitutes a single claim. There may be several individuals affected by the action of the solicitor eg multiple beneficiaries where a solicitor has stolen money from an estate.

35. Many argued that the proposals 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.

36. The Law Society suggested that we should explore targeted ways of managing the risk of investment scheme applications without "…excluding clients who have not chosen to engage in high-risk investment schemes…". They suggested that this might include capping the total amount that could be claimed in relation to a scheme either in aggregate or per applicant.

37. We also had useful suggestions from respondents including some insurers and compliance professionals relating both to steps that a solicitor, or a potential investor/client, might be expected to take to investigate a scheme or transaction to decide if it was genuine. This would reduce the risk of applications against the Fund materialising in the first place.

Data

38. Several respondents including the Legal Services Consumer Panel asked for further data about applications to and payments made from the Fund to better understand the impact of the proposals. We have with this consultation published further data about and analysis of grants from the Fund.

Revising our proposals

39. In light of the responses we have looked hard again at several areas and are suggesting 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 such as from solicitor involvement in dubious investment schemes.

40. Further details of these proposals are set out in the next section of this document.

Proposals that we are going ahead with

Litigation costs and application fee support

41. We consulted on proposals to target the operation on its core purpose of making good the direct financial loss caused by the actions of the solicitor or firm. This included a proposal to no longer pay grants to applicants to cover litigation costs incurred to pursue alternative means of redress.

42. There were some concerns raised about the impact that this may have on some people's ability to seek other courses of redress. However, the individual applicant's ability to take alternative action to recover their loss, informs decisions to refuse, or refuse to process, an application because alternative forms of redress may be available. We will advise applicants on our expectations in relation to them pursuing other means of redress - proportionate to their circumstances as we process their application.

43. In this context, we reserve the right to pay some costs on an exceptional basis, proportionate to the nature of the application. This might be where we think that the pursuit of another remedy is highly likely to be successful, but the applicant does not otherwise have the financial resources to pursue them.

44. We will also adopt our proposal to no longer pay for people to get professional help to help them apply for a grant from the Fund. We remain of the view that it should not be necessary to seek professional help to make an application to the Fund. We will make sure that the application process is

made as simple as possible and we have appropriate support available to help applicants through the application process.

Circumstances where a solicitor has failed to have PII cover in place

45. We will adopt our consultation position to limit applications to the Fund relating to a firm having failed to get the required insurance, to firms that were authorised by us. This would change the position where we may pay grants if the firm responsible to the loss was not authorised by us and the SRA was the only organisation that could have authorised them. This applied only to certain business models – sole practices and partnerships. We think that it is appropriate that we target the Fund to those that we authorise. This position better ensures consistency and is easier to understand – either the firm was authorised by us or it was not.

46. We have also decided to proceed with our consultation proposal to make it clear in our rules 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 winding up process. One view raised on consultation was that the Fund should cover situations where the law firm's insurer is insolvent as clients cannot have any influence over this. It was also highlighted that the Financial Services Compensation Scheme would not always meet the liability especially in cases where law firms had a turnover of greater than £1,000,000.

47. We remain of the view that the finite Fund should not provide a safety net for all circumstances where insurance is not in place. Our proposed new purpose statement, set out in the next section of this document, emphasises a focus on providing redress caused by the ethical failure of those that we regulate.

Maximum payments from the Fund

48. We will proceed with our proposal to reduce a 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.

49. Most grants from the Fund remain relatively low. Over the period between 2010 to 2018 more than 75% of grants made were for less than £5,000. A limit of £500k would have seen lower payments for around 0.4% of applications paid (or where we are reserving a possible payment). This would have amounted to £14m, 10% of the amount paid in value. Applications for grants above this sum generally relate to probate, mortgage monies and damages settlements.

50. We have reviewed available information about the maximum payment levels of other regulators and compensation schemes. Please see the supporting evidence and analysis for more detail. Two of the three other legal service regulators in England and Wales that have a compensation scheme have a limit of £500k (Institute of Charted Accountants of England and Wales probate

scheme and CILEx Professional Standards). The Council for Licensed Conveyancer's (CLC) operating framework emphasises that they have absolute discretion about payments without specifying a maximum payment level.

51. We will maintain our existing discretion to pay a higher sum if we consider it to be in the public interest on an exceptional case by case basis. This has been used in the past to, for example, allow full recovery of damages awarded to a paraplegic applicant following a successful clinical negligence claim.

Barristers and experts

52. We will proceed with our proposal to exclude applications from barristers and other third-party experts for unpaid fees. Many consultation respondents argued that barristers and experts should be eligible to claim where they have suffered loss caused by a solicitor because this helps maintain trust in the profession.

53. However, 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.

Conduct and behaviour of the applicant

54. 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.

55. We consulted on proposals to apply a clearer and more robust approach about how to take account the applicant's behaviour when assessing applications. We proposed setting out the circumstances when the conduct of the applicant may warrant refusal or reduction. We highlighted that this should include when appropriate steps were not taken to confirm that a high yield investment scheme were genuine and the solicitor's role in it was legitimate. We asked for views on what the appropriate steps might be.

56. We also consulted on introducing an explicit requirement for full and frank disclosure by an applicant when requesting a payment from the Fund. This would strengthen our ability to get the evidence we need to understand the circumstances leading to the loss. This may include the behaviour of the applicant, as well as the role of the solicitor.

57. We will proceed with both of these proposals.

58. The Law Society said it supported the around full and frank disclosure, provided that the rules are communicated to applicants in a way that they understand. Other respondents including consumer organisations agreed information about the expectations of an applicant should be made clear and easily accessible.

59. There were mixed views about whether we should take a more robust approach to reducing or refusing payments based on an applicant not having undertaken sufficient due diligence in relation to an investment scheme.

60. Many respondents including from law firms agreed that the potential investor must take some responsibility. Views put forward included that if it seems “too good to be true” it probably is. Respondents suggested a number of investigative steps that a potential investor could take.

61. Another argument put forward was that due diligence would only be the solicitor's responsibility where that is the specific instruction from the client. Respondents suggested a number of investigative steps that a potential investor could take.

62. Some respondents including from compliance and consumer organisations thought that there were steps that a solicitor could take to advise prospective investors. Suggestions included providing written information on what steps and research a client should take before proceeding with a transaction.

63. Some respondents put forward the view that we should not look to reduce or refuse payments based on the behaviour of the applicant if the loss was the fault of the solicitor, as that should be the determining factor.

64. We will develop guidance to help individuals understand the steps that they take to investigate an investment scheme before committing money to it. This will draw on the helpful suggestions made by respondents. Guidance will highlight the factors that we will take into account when deciding that we may refuse or reduce a grant on the basis of an applicant’s behaviour. This might for example include recklessly entering into a transaction without undertaking sufficient research or not discussing the merits of the scheme with the solicitor or law firm. We will make clear that we consider each case on its own merits, taking these factors into account.

Contributions to the Fund

65. We also asked for views on whether our current formula for setting contribution levels remains the best way to apportion costs of maintain the Fund. Views expressed are set out in our summary of feedback. This included a suggestion that we should consider stopping paying intervention costs from the Fund. To do so would see costs of interventions having to be met through the practising certificate fees. These are discrete issues that we are not taking forward as part of this exercise, but may review at a later date. We will be consulting on contributions levels later this year.

Section three: Our revised proposals

Purpose and operating principles

66. We appreciate that the Fund plays an important role in protecting consumers and the reputation of the profession. However, 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"[3]. It is a finite and discretionary fund of last resort. We must make prioritisation decisions.

67. We consider that it is important that we are clear and transparent about the purpose and operating principles of the scheme. Setting clear expectations about the circumstances when a claim is likely to be paid is likely to play an important role in promoting trust in the profession and regulated legal services.

68. The consultation revealed divergent understanding of, and views about, the purpose of the Fund and the circumstances in which people should be able to benefit from it. We have thought again about the Fund's purpose and how we should draw the boundary of its scope in a way that is easily understood. We are of the view that the Fund should focus tightly on losses to consumers of legal services caused directly by the ethical failures of solicitors and law firms providing them services. This means resisting expanding its reach to try and cover all circumstances where a consumer may otherwise suffer a financial loss.

69. We have developed a statement with this in mind and would welcome stakeholder views on whether this provides the clarity and transparency that people have asked for.

Purpose Statement

The SRA Compensation Fund is a fund to protect consumers of legal services and thereby uphold trust in the integrity of the profession, by alleviating financial loss caused by fundamental ethical failures – such as the dishonesty or lack of integrity of solicitors or regulated firms.

The SRA achieves this aim by making payments where:

- those for whom services are provided have lost money as a result of their solicitor or firm's dishonesty

[3] *RvLaw Society ex p Mortgage Express* [1997] 2 All ER 348, Lord Bingham CJ delivered the judgement to the Court

- where the solicitor or firm has misappropriated or otherwise failed to account for their money, or

- they have a claim which should have been covered by the firm's mandatory indemnity insurance, but where the firm has failed to take out a policy of insurance as required to under our rules.

The Fund is financed through contributions from solicitors and law firms that we regulate and is a discretionary fund of last resort.

This means that no person has a legal right to a payment, and if a payment is made then this will make a contribution to, but not necessarily replace, all funds lost.

We will impose caps and limits on the amounts that can be recovered in certain circumstances and will publish guidance on what those circumstances are.

Those applying for a payment from the Fund will need to demonstrate that they have taken appropriate steps to exhaust all other avenues of redress and have acted in a way that has not contributed to their loss.

Notwithstanding, we limit the types of loss that can be recovered, and the circumstances in which that loss can arise. For example, this must arise directly from the acts of, or omissions of, a law firm we regulate – or a solicitor when working on their own and engaging with a client directly to provide the work. The work must form part of the usual professional activities of a solicitor.

When considering whether to make a payment, we aim to be fair, consistent and transparent in the way we prioritise applications, and will make decisions according to detailed criteria set out in our rules and guidance that we publish.

Consultation question 1: Do you agree that the proposed purpose statement will help people understand the circumstances when a claim is likely to be paid?

Eligibility

Focus on individuals, small businesses, small charities and trusts

70. In the light of consultation responses, we propose to change the current criteria to allow applications to the Fund from individuals, small businesses, small charities and small trusts without requiring evidence of wealth or hardship before they are eligible to make the claim.

71. We agree that we should not define the Fund as a hardship fund, and that this is not the statutory basis on which the Fund was set up. We believe however that we can prioritise payments based on the impact of loss in the following way.

72. First, by maintaining our current gateway criterion that excludes large businesses with a turnover of more than £2m from eligibility. We will also proceed with our consultation proposal to extend eligibility to charities and trusts with income/ assets of more than £2m.

73. Our rationale for excluding large businesses from eligibility in 2015 was that they are likely to be regular users of legal services and in a position to make sophisticated purchasing decisions, understand the risks involved and be able to take steps to protect themselves where they consider this to be necessary.

74. This is consistent with our view that the overarching purpose of our regulatory protections and therefore of the Fund should be to protect those “consumers” that need protecting. This is a term often used to describe individual and small business end users of services.

75. We also think we should take a consistent approach with large charities and trusts. These organisations will have many of the same characteristics as large businesses and the rationale for excluding large businesses set out above can be said equally to apply. Other compensation schemes, as well as the Legal Ombudsman, exclude charities and trusts from eligibility, as well as large businesses. Please see our supporting evidence and analysis for further examples.

76. We will not proceed with our proposals to set eligibility criteria for individuals based on wealth thresholds. We are persuaded by the arguments that this approach would be resource intensive, and difficult to administer fairly in practice.

Hardship

77. Further, having reflected on views expressed on consultation we propose removing the “hardship” criteria that currently exists for otherwise eligible individuals, small businesses, small charities and small trusts.

78. We are of the view that the current formulation of the hardship criteria presents some perverse inconsistencies. For example, the hardship criteria apply where the loss is caused where a solicitor has failed to account but not

where the loss is caused by the solicitor's dishonesty[4]. The impact of the loss for the consumer may however be the same in both circumstances.

79. All individuals who engage with a solicitor on a personal matter are assumed to have suffered hardship, where hardship criteria apply. On the other hand, small businesses have to submit financial information and demonstrate hardship in the same situations. This ignores the fact that some individuals will be better able to bear the administrative burden of submitting this information than some small businesses. And some wealthy individuals will be better able to bear the loss that they have incurred than some small businesses. This is salient given that, as noted below, the requirement to submit financial information may act as a deterrent to pursuing a claim.

80. We do not have a set threshold for what "hardship" means in practice. We do not operate any type of "means tested" assessment usually associated with hardship tests. We turn down only a very small number of applications because they cannot demonstrate hardship. However, a large proportion of small businesses discontinue their applications against the Fund at the point that we ask for financial information and begin to scrutinise the impacts of their loss under the current system. This indicates that this process has a deterrent effect, which may extend to applicants that may have met our hardship test and received a grant.

81. In relation to individuals, evidence suggests that the financial resilience of UK adults is low even for the middle income groups and/or age groups that are more likely to suffer a loss because of the legal service they are being provided (for example conveyancing and/or probate). For example, almost two thirds of UK adults have no cash savings or savings of less than £5,000. Another report finds that for "Middle Britain" around two thirds of typical working families have less than three months outgoings in savings and only a third feel confident that they could handle a financial crisis.

82. We think that this means that it is likely that most people will be significantly impacted from any level of financial loss caused by a solicitor - including the frequent smaller payments made currently from the Fund (for applications received to date at least 75% of payments are less than £5,000).

83. For the reasons explained, we propose that instead of a hardship test, we use our residual discretion to allow us to consider those rare cases in which the impact of loss is disproportionately low, and it would not be appropriate to meet it from a finite fund.

84. This might be because an applicant has already received a significant level of compensation from another scheme or from an insurer who has not paid in full. Or for any other reason the loss is immaterial when viewed in context of the applicant's wealth or circumstances.

[4] Unless the claimant is a large charity or trust where the criteria apply to both causes of loss

85. We will also produce guidance to help clarify other factors that might result in us refusing or reducing a claim using our residual discretion. This might include for example where client money that has been lost in tax avoidance schemes or other schemes where the client's purpose runs contrary to public policy.

Consultation question 2: Do you agree with our revised proposals to remove hardship tests for all individuals, small businesses, small charities and small trusts?

Consultation question 3: Do you agree with the proposal that we use our residual discretion to refuse or reduce payments on rare occasions when we consider the loss will be immaterial or substantively compensated elsewhere?

Limiting applications to those for whom the legal service has been provided

86. In the previous section we confirmed our decision that barristers and experts will no longer we eligible to claim on the Fund. We propose to further narrow who can make a claim, so that this is available only to those for whom the legal service is being or has been provided. This is in line with our proposed purpose for the Fund, set out at the beginning of this section, and our explanation for this.

87. This would include beneficiaries and others who are not under client retainers but are receiving the legal service in question. This mirrors the position of the Legal Ombudsmen in relation to their scheme rules.

88. Other compensation schemes such as those of the Royal Institution of Chartered Surveyors and CILEx Professional Standards limit applications to the direct clients or former clients of the firm or professional that has caused the loss. The CLC's rules on the other hand are similar to our current approach. (See our supporting evidence and analysis for more detail on these schemes).

89. Examples of applicants that would no longer be eligible to claim on the Fund include:

    - Buyers who have lost money because of the dishonesty of their seller's solicitor in a conveyancing transaction.

    - Third parties in personal injury/medical negligence applications such as credit hire or vehicle repair companies where the solicitor has not paid their costs out of damages received because they have been lost or stolen.

    - The opposing party in a legal proceeding such as spouses in a divorce matter where the other solicitor is holding and then steals the money set aside for a financial settlement.

90. It is not common for the Fund to pay grants in relation to these applicants, but when paid they tend to be for large sums.

91. Recourse for those that have suffered a loss at the hands of a regulated provider who is not providing them with legal services is likely to be sought against the other party in the proceedings or transaction directly. The other party could in turn seek redress from their own solicitor.

92. In many instances solicitors' insurance will cover the claim for loss[5] but it might not in all instances, for example if the loss is a result of dishonesty by a sole practitioner.

93. We welcome feedback from stakeholders around the impacts of excluding applications from those who are not the client or consumer of the services in question. We are also interested in your views as to whether we should expressly include a right for the client of the regulated provider whose actions have caused the loss to make a claim to the Fund in circumstances where they have been held liable personally for the loss, and been unable to make a claim against their own solicitor.

Consultation question 4: Do you agree that the Fund should only be available to those who are the clients, or recipients, or the services of the solicitor/firm in question?

Consultation question 5: Do you think we should expressly include a right for the client of a solicitor whose actions have caused the loss for which they are liable to make a claim on the Fund, if no other redress is available?

Applying a cap to multiple applications

94. In light of views expressed on consultation, we have looked again at how we might target high value connected applications. We want to do this in a way that provides appropriate redress while improving our ability to plan and prioritise payments from the Fund. This will make it easier for us to be more consistent in the level of contributions that we collect each year, providing greater certainty of outgoings for those we regulate

95. Certain other compensation schemes adopt cumulative limits in various forms for multiple applications, for example an aggregate sum for a single year or a total per firm or per intervention[6] (for more detail see supporting evidence and analysis).

96. We propose to introduce a new mechanism to cap payments:

    - **arising from a single or connected event**: Whilst the most obvious immediate application for a capping mechanism is for applications arising from solicitors' involvement in investment schemes, this cap should

[5] where the loss is due to a seller/seller solicitor this may not necessarily be the sellers' solicitor insurance as decided in the recent Court of Appeal judgment Dreamvar vs Mischon
[6] For example RICS, CILEx.

potentially apply to a range of circumstances where applications are connected. This could potentially also include, tax avoidance schemes, litigation funding schemes as well as other events giving rise to multiple client losses. Schemes could be connected for example by being advertised together, or administered together through the same solicitor or firm

- **which are likely to exceed a specified financial threshold**: we propose to initially set this at £5m. Fixing a threshold provides certainty for the Fund, the profession and the public. The aim is to allow us to better manage the small number of very high value applications that, if paid in full, would threaten the viability of the Fund without significant increases to the level of contributions. It is not designed to impact on the average application. We consider £5m to be a proportionate threshold given the profile of very high value claims that the Fund currently faces applications in relation to. We may periodically amend this figure based on the changing profile of these types of claims.

97. We also propose to set a total cap of £5m for any single scheme that is captured. This approach provides maximum clarity and certainty regarding the total amount of compensation that will be paid for each eligible scheme.

98. In practice, once we are aware of an issue that could give rise to multiple applications our general experience is that potential applicants can be identified relatively quickly and signposted to make a claim. This can be as a result, for example, of intelligence gathered either through our own investigation teams or from information gathered by our intervention agents. Increasingly we are seeing cases in which applicants are forming online groups which also means that multiple applicants can mobilise very quickly and be legally represented as a group.

99. Quite often investors will have shared the same experience and may already have worked closely together to explore other remedies including group litigation. This will give us a good idea of the total potential value of applicants, and the number of people affected. Once we know that we are managing a multiple claim, we would if appropriate launch a communications plan to seek out any potentially connected applications.

100. We propose to provide ourselves with the flexibility to apply any of a number of options for apportioning the £5m between applicants depending on the nature of the issue. This may include:

    a. **The money is divided equally amongst all applications brought within an advertised time limit.** There may be common factors in the applications which make it appropriate and proportionate to set the same limit per claim. For example, many thousands of applicants may have suffered losses when donating into a litigation funding scheme and it might be appropriate after taking reasonable steps to find as many potential applicants as possible to divide the £5m equally.

b. **An amount per claim is calculated based on the features of the event.** For example, all investors recover the minimum or average investment for the scheme. A property scheme may fail with applicants losing different amounts. Individuals have had the choice to invest in single unit or take on greater risk by investing in multiple units. They would have had access to the same information and opportunity to investigate the risk of the scheme. Some investors will get their investment back in full. Some who invested in more than one unit or above the average investment will not get all of their money back. If an applicant has already received redress from another scheme in relation to the same event, we may take that into account so that when combined they receive a fair total.

c. **By setting an amount for each claim recovered per scheme based on what another regulator may pay in the same circumstances.** For example, there may be cases where another regulator is paying for losses arising from the acts or omissions of a professional such as a financial advisor in relation to an investment scheme. If we receive applications relating to solicitors involved in the same, or a similar scheme, we may choose to pay out at the same level

101. This approach and the thresholds that we are proposing will allow us to assess these applications fairly and consistently and allow all eligible applicants to receive a reasonable level of redress, that compares favourably to comparable schemes with capping mechanisms. While also managing the potential liability faced by the Fund and subsequent impact on the profession.

102. It is worth noting that in relation to many investment schemes, potential liability for which the Fund has to reserve funding is not fully realised. This is because, for example, some or all of the losses are recovered through other means. Or because once we have obtained the necessary evidence and investigated the claim the applicants are not eligible for payment. This may commonly be because the work was not the usual business of the solicitor.

Consultation question 6: Do you agree with the proposal to introduce a multiple application cap?

Consultation question 7: Do you agree that we set a financial threshold of £5m? Please provide any available evidence to support your response.

Consultation question 8: Do you have a preference for any method of apportionment or that we retain the option to apply any of these depending on the circumstances?

Consultation question 9: Do you have any other comments on the features of the proposal to cap multiple claims?

Defining a single claim on the Fund

103. We do not currently set out a definition of a single claim that would attract our maximum payment limit and whether it would apply, for example, to a single retainer or multiple applicants from a connected pattern of behaviour. We suggested in the consultation that the general principle should be that where the loss of money relates to single retainer, that should be dealt with as a single claim on the Fund.

104. Only a few respondents provided any comment in response to whether we had set out the right approach for assessing when a maximum payment had been reached. Some said we had not given enough information about the impact on payments to be able to take a view. A small number of respondents including consumer organisations and the TLS agreed that it would be helpful to set clear rules to establish when a maximum payment has been reached but did not agree with the specific proposal i.e. linking to a single retainer we had made.

105. In disagreeing, respondents including the Legal Ombudsman and a PII broker drew on potential impacts related to the examples that we provided to question the fairness of our proposed approach, linked to a single retainer.

106. One example provided was where a separating couple lose the money by jointly instructing a solicitor to sell the family home that is worth significantly more than £500k and they are restricted to £250k each, half of our £500k maximum payment. Similarly, respondents thought there could be an impact on charities who might jointly instruct a solicitor to act on their behalf in relation to administering an estate where they are each a beneficiary.

107. We agree that linking a single claim to a single retainer may lead to an unfair outcome is some circumstances. We agree that our approach should be 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).

108. We propose instead for the single claim limit to apply to each individual applicant receiving payment. Each individual applicant will receive a maximum of £500k for the loss arising from a single event or set of circumstances. This would mean that in the example about the separating couple given above, each person could receive a payment of up to £500k. We would not consider any further application if there are additional losses in excess of the maximum payments received.

109. In developing this proposal, we are also considering our new proposal to apply an absolute cap of £5m where we receive multiple applications arising from a single or connected event. This could potentially mean, for example in the case of large estates, or where many individual applicants have lost money in a failed property scheme then applicants will receive an amount lower than the £500,000 limit because we apply the cap. We think the

combination of the revised approach to a single claim and proposed cap for multiple applications is a fair way to manage the impact of high value, connected applications.

Consultation question 10: Do you agree with the revised approach to how we will apply the single applications limit?

Consultation question 11: Do you have any other comments on the proposals and impacts we have set out in the consultation? Are there any impacts particularly EDI impacts that you think we have not identified?

Questions

We are keen to hear your views on our changes to our Compensation Fund. The full list of our questions are below.

1. Do you agree that the proposed purpose statement will help people understand the circumstances when a claim is likely to be paid?

2. Do you agree with our revised proposals to remove hardship tests for all individuals, small businesses, small charities and small trusts?

3. Do you agree with the proposal that we use our residual discretion to refuse or reduce payments on rare occasions when we consider the loss will be immaterial or substantively compensated elsewhere?

4. Do you agree that the Fund should only be available to those who are the clients, or recipients, of the services of the solicitor/firm in question?

5. Do you think we should expressly include a right for the client of a solicitor whose actions have caused the loss for which they are liable to make a claim on the Fund, if no other redress is available?

6. Do you agree with the proposal to introduce a multiple application cap?

7. Do you agree that we set a financial threshold of £5m? Please provide any available evidence to support your response.

8. Do you have a preference for any method of apportionment or that we retain the option to apply any of these depending on the circumstances?

9. Do you have any other comments on the features of the proposal to cap multiple claims?

10. Do you agree with the revised approach to how we will apply the single application limit?

11. Do you have any other comments on the proposals and impacts we have set out in the consultation? Are there any impacts particularly Equality Diversity and Inclusion impacts that you think we have not identified?