

Review of the compensation fund

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<https://rules.sra.org.uk/globalassets/documents/sra/committees/compensation-fund-review.pdf>

Executive summary

The Financial Protection Committee's compensation fund Review Working Party has completed its 18-month review of the compensation fund under terms of reference agreed by the committee following consultation with the representative Law Society.

Currently, public financial protection in respect of solicitors in private practice is afforded through a combination of four arrangements: compulsory professional indemnity insurance; the compensation fund; the intervention process (which includes Statutory Trust Account distribution) and Inadequate Professional Services ("IPS") awards. The SRA is responsible for the first three arrangements and the Legal Complaints Service is responsible for IPS awards. This report concentrates on the compensation fund but necessarily considers how the compensation fund interlocks with the other arrangements.

The Working Party concluded that the underlying principle is client protection. The existing arrangements described in this report already provide a great deal towards a cohesive and complete protection which only needs some adjustment to improve and align it. Anomalies and peculiarities are inevitable in different arrangements that address different needs and total protection under a single scheme is probably an unattainable ideal.

The main recommendations of the Working Party are as follows.

- The Working Party's recommendation that the limit of the grant be increased to £2 million (with discretion) has been implemented in the [compensation fund Rules 2009](#) (<https://rules.sra.org.uk/compensation-fund-rules/>) that came into force on 31 March 2009 (see conclusion 6, page 14 of the full report).
- The Working Party's recommendations to extend the time limit for applications to the compensation fund to 12 months and to retain the discretion to exceed this as appropriate have been implemented in the compensation fund Rules 2009 that came into force on 31 March 2009 (see conclusion 7, page 15).
- From 1 October 2009 the compensation fund should not entertain new counsel fee claims. Once the Bar's rules have been changed and contracting between solicitors and Counsel is adopted, claims from Counsel will have an alternative means of redress through the courts (see conclusion 9, page 16).
- The compensation fund reserve should be maintained at a minimum of twice the average annual value of claims over the previous seven years plus the estimated value of three months recharges (see conclusion 27, page 36).
- Recharges against the compensation fund should be made only for the direct costs of its administration. The wider costs of regulation should be funded from practising certificate income (see conclusion 28, page 41).
- As part of its review the Working Party has compared the Fund with other jurisdictions' funds and has concluded from the information available that the Fund, combined with professional indemnity and the Statutory Trust Account process, provides equal, if not superior, protection. The Working Party has also considered aspirational criteria produced by the American National Client Protection Organisation (ANCPO) to assist jurisdictions in evaluating their own compensation arrangements' performance. The principal areas where the Fund does not meet the aspirational criteria relate to governance and the dissemination of information to stake holders (see conclusion 31, page 48).
- The Working Party concluded that the governance arrangements up until 31 March 2009 were unacceptable as the SRA had responsibility without power and the Society as trustee had power without responsibility. The position has improved since 31 March 2009 because now the SRA Board has clear responsibility for some aspects of the compensation fund. The notable exceptions are responsibility for setting contributions (which has been retained by the Council) and investment strategy (which the Board had agreed to delegate to a Law Society Committee). The Working Party recommends that the SRA Board reverse the delegation to the Law Society's Investment Committee. The Working Party is of the view that ultimate responsibility for all aspects of the compensation fund should be at arms length from the representative body and should be vested in the SRA Board. This would go some way to addressing the requirements of ANCPO 1.3 and 2.4 as set out paragraph 179 of the main report (see conclusion 32, page 51).
- From the perspective of clients, aligning the compensation fund to the Minimum Terms and Conditions would eliminate most, if not all, of the gaps in client protection. Before any such change could be properly considered, empirical research would be needed to determine the likely cost implications of the change and on that basis an informed decision could be made. The Working Party recommends that this research is carried out (see conclusion 33, page 56).

Leaving aside the aligning of the compensation fund and the Minimum Terms and Conditions, the Working Party concluded that whilst the compensation fund could be improved, it had served the public and profession very well and represented the best of the currently available options. The other alternatives were unviable and/or expensive and would involve major changes and risks that would be out of proportion to the problems to be addressed.

The scale of the review was such that inevitably some work remains outstanding and new areas for action have emerged during the course of the review. The key future action points are as follows.

- Complete the review of the provision of information to stakeholders
- Review the new compensation fund Rules to assess whether further changes are desirable in the public interest
- Consider how the protection afforded by the three schemes (including the compensation fund) will be adapted to accommodate the proposed alternative business structures (ABSs)
- Keep the levels of cover under periodic review
- Investigate the cost and practicality of aligning the compensation fund rules with the Minimum Terms and Conditions (MTC)
- Complete the equality impact assessments of the compensation fund.

Key documents

Information pack, April 2014

The documents listed below together comprise an information pack that presents the review's findings as of April 2014.

- [Compensation arrangements – snapshot of where we are \(PDF 32 pages, 650K\)](https://rules.sra.org.uk/globalassets/documents/sra/compensation-arrangements-snapshot.pdf)
[\[https://rules.sra.org.uk/globalassets/documents/sra/compensation-arrangements-snapshot.pdf\]](https://rules.sra.org.uk/globalassets/documents/sra/compensation-arrangements-snapshot.pdf)
- [Comparative element – legal and non-legal regulators \(PDF 63 pages, 599K\)](https://rules.sra.org.uk/globalassets/documents/sra/comparative-study.pdf)
[\[https://rules.sra.org.uk/globalassets/documents/sra/comparative-study.pdf\]](https://rules.sra.org.uk/globalassets/documents/sra/comparative-study.pdf)
- [compensation fund accounts – summary \(PDF 5 pages, 161K\)](https://rules.sra.org.uk/globalassets/documents/sra/compensation-arrangements-review-summary.pdf)
[\[https://rules.sra.org.uk/globalassets/documents/sra/compensation-arrangements-review-summary.pdf\]](https://rules.sra.org.uk/globalassets/documents/sra/compensation-arrangements-review-summary.pdf)
- [compensation fund claims data – data considered by Economic Insights \(PDF 39 pages, 2MB\)](https://rules.sra.org.uk/globalassets/documents/sra/compensation-fund-review.pdf)
[\[https://rules.sra.org.uk/globalassets/documents/sra/compensation-fund-review.pdf\]](https://rules.sra.org.uk/globalassets/documents/sra/compensation-fund-review.pdf)
- [Legal Services Consumer Panel – report on financial arrangements \(PDF 63 pages, 475K\)](http://www.legalservicesconsumerpanel.org.uk/ourwork/Financial%20Protection/FPAs%202013%2006%2010%20final.pdf)
[\[http://www.legalservicesconsumerpanel.org.uk/ourwork/Financial%20Protection/FPAs%202013%2006%2010%20final.pdf\]](http://www.legalservicesconsumerpanel.org.uk/ourwork/Financial%20Protection/FPAs%202013%2006%2010%20final.pdf)
- [Legal Services Consumer Panel – Risk and responsibility Implications for regulating legal services \(PDF 45 pages, 346K\)](http://www.legalservicesconsumerpanel.org.uk/ourwork/Financial%20Protection/2013%2006%2010%20riskandresponsibility.pdf)
[\[http://www.legalservicesconsumerpanel.org.uk/ourwork/Financial%20Protection/2013%2006%2010%20riskandresponsibility.pdf\]](http://www.legalservicesconsumerpanel.org.uk/ourwork/Financial%20Protection/2013%2006%2010%20riskandresponsibility.pdf)

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