Solicitors Regulation Authority

Closed Consultation

Client money in legal services - safeguarding consumers and providing redress: Delivering and paying for a sustainable compensation fund

14 November 2024

- The consultation period ended on **21 February 2025**
- Watch our webinar on the review and what you need to know [https://www.youtube.com/watch?v=hZn2gb2AVio&ab_channel=SolicitorsRegulationAuthority]
- You can download the consultation paper [#download] or read it below

Next steps

We have published a summary of feedback received, and our response, to specific questions within the consultation which addressed proposed 2025/26 contribution levels. This is to coincide with publication of the proposed practising certificate fee and compensation fund contribution levels for 2025/26.

- Download analysis of responses to the consultation [#responses]
- Download consultation responses [#responses]
- Our consumer protection review [https://qltt.sra.org.uk/home/hot-topics/consumer-protection-review/] information outlines our areas of immediate focus

About this consultation

We are consulting on proposals and ideas aimed at safeguarding client money and providing redress through our Compensation Fund when money is lost.

We are now consulting on proposals and ideas in three areas:

- Part 1: The model of solicitors holding client money [https://qltt.sra.org.uk/sra/consultations/consultation-listing/holding-client-money/] – should we be looking at ways to reduce the client money held by solicitors?
- Part 2: Protecting the client money that solicitors do hold [https://qltt.sra.org.uk/sra/consultations/consultation-listing/client-money-legal-services/] – what controls, checks and balances are appropriate?
- Part 3: Delivering and paying for a sustainable Compensation Fund– how should payments from the profession be calculated and payments from the Fund to reimburse consumers be allocated?

The following background is repeated in all three consultations:

Background

Most consumers will only use a solicitor at a few points in their lives to help navigate big life events. This includes events which involve significant financial transactions, such as buying property, receiving money from an inheritance or personal injury settlement. It is important that people can trust solicitors with their money and their affairs. This means having the right regulatory protections and safeguards in place while ensuring that the sector overall offers a broad range of services to meet consumers' needs.

We also need to keep the regulatory regime under review and predict and respond to developments in the sector. Recently, both the number and size of firms that we have had to intervene into to protect the public has risen sharply, with increasing detriment to clients from client money having gone missing or being unavailable when it was needed to complete a transaction. A substantial proportion of regulatory breaches which we investigate concern issues around the handling of client money. So, we launched our Consumer Protection Review in February 2024 to examine whether we need to make changes.

There are some changes that we have already been able to make. These include issuing warning notices on mergers and acquisitions [https://qltt.sra.org.uk/solicitors/guidance/mergers-acquisitions-sales-law-firms/] and on money missing from the client account [https://qltt.sra.org.uk/solicitors/guidance/money-missing-client-account/]; tightening up checks when reviewing firms' financial information and bank statements; reviewing processes for putting conditions on firm authorisations; and starting to put in place a new proactive investigations team.

This consultation exercise sets out our proposals and ideas for further changes we think are needed. These have been informed by the engagement and research that we have already undertaken.

Consumers are at the heart of this review. Therefore, we conducted in-depth research with consumers to help shape our understanding and positions. We also engaged with a full range of stakeholders through different events and exercises, and we have commissioned research on specific topics relating to consumer protection.

At the outset of our review, we made clear that no options were off the table. This allowed for open discussion and the exchange of ideas. We set out three key areas to prompt discussion and our engagement indicates that these were the right areas of focus.

We are now consulting on proposals and ideas in three areas:

- Part 1: The model of solicitors holding client money [https://qltt.sra.org.uk/sra/consultations/consultation-listing/holding-client-money/#one] – should we be looking at ways to reduce the client money held by solicitors?
- Part 2: Protecting the client money that solicitors do hold [https://qltt.sra.org.uk/sra/consultations/consultation-listing/client-money-legal-services/#two] – what controls, checks and balances are appropriate?
- Part 3: Delivering and paying for a sustainable Compensation Fund [https://qltt.sra.org.uk/sra/consultations/consultation-listing/delivering-sustainable-compensation-fund/#three] – how should payments from the profession be calculated and payments from the Fund to reimburse consumers be allocated?

We have also responded to feedback that 'consumer protection review' was an unhelpfully broad title. We have adopted a title for this consultation exercise which we think better reflects the scope – client money in legal services: safeguarding consumers and providing redress.

The consultation papers include some firm proposals that we hope could be delivered relatively quickly. There are also more formulative ideas that require further development, which will be informed by feedback from this consultation. And in some areas, notably changes to the model of solicitors holding client money, we would need to work with partners to enable suitable alternatives.

This consultation will run until 21 February 2025.

Insights so far

As set out above, the proposals and ideas that we are consulting on have been informed by what we have heard from stakeholders so far as well as the external research and internal work that that we have done. Our engagement activity (see Annex A for more details [https://qltt.sra.org.uk/sra/consultations/consultation-listing/holding-client-money/#heading_36fb]), including roundtables with a full range of stakeholders, has given us some insights and ideas.

We have also drawn on five pieces of external research, covering:

- Consumer insights – expectations and preferences [https://qltt.sra.org.uk/sra/research-publications/client-money-consumer-protection-arrangements/]
- Future market developments – risks to client money [https://qltt.sra.org.uk/sra/research-publications/future-market-changes-legal-sector-client-money/]
- Different approaches to managing client money [https://qltt.sra.org.uk/sra/research-publications/regulators-jurisdictions-hold-client-money/]
- Compensation schemes in other regulatory bodies and jurisdictions [https://qltt.sra.org.uk/sra/research-publications/how-regulators-jurisdictions-manage-consumer-compensation/]
- [https://qltt.sra.org.uk/sra/research-publications/regulators-jurisdictions-hold-client-money/] Online polling of consumer views [https://qltt.sra.org.uk/sra/research-publications/consumer-polling/]

And we have considered our own proactive inspection work, data analysis and learnings from the recent failures that we have seen. The section below provides a high-level overview of what we have learnt.

Holding client money

We have heard mixed views about whether risks to consumers and firms could be significantly reduced if holding client money was not an assumed role of a law firm. There were also mixed views about whether the benefits outweigh potential disadvantages.

Some people, including the Legal Services Consumer Panel, supported the idea of alternatives to solicitors directly holding client money to reduce risk. Individual consumers and the public started out as sceptical about the potential benefits of alternatives, but the alternatives became more popular as people's knowledge about what they were increased.

Within the profession, some firms said that they were already looking to move away from holding client money to reduce risk and insurance costs. Others said that they were not opposed in principle but did not think that there were good, affordable alternatives available. But others were opposed – with questions over whether alternatives were more secure, concerns about limiting the service they offered to clients and whether involving a third party would add cost and delay.

We asked questions about firms being able to keep some of the interest that was made on the client money that they held. Consumers felt that as it is their money, they should receive any interest. As a minimum, the interest rates should reflect what they would have received in their own savings account. We heard that some firms used part of the interest to subsidise their operating costs and/or keep their fees down, or to improve their profitability. Some firms told us that they would not be able to remain in business without the money raised from interest on client accounts.

Through our inspection and investigations work, we have seen examples of firms who are not returning client money promptly at the end of a case, leading to high residual balances. We have heard from some compliance experts that this is not always treated as a priority by firms and their employees.

Our research highlighted examples of alternative arrangements for handling client money from different sectors and jurisdictions. It found that while there were no easily applicable models that could be lifted

wholesale and applied to the legal sector in England and Wales, there were features that could help reduce risks to client money which should be explored further.

Protecting client money

Unsurprisingly, finding ways to reduce risks was seen as important by consumers and the profession. We heard lots of different ideas about controls and protections that we might improve. Among solicitors and compliance experts, there was a widespread view that the reporting accountants' external audit function for risks to client money could be strengthened. This was both with regard to making sure that firms complied with existing requirements and improving the consistency of how effective the audits are at identifying risks or problems. Our intervention and thematic review activity has shown a significant minority of firms not complying with requirements.

Another area where we commonly received ideas for improvement was around checks and balances within firms. For example, there was concern expressed about potential conflicts when managing partners were also holding key compliance roles. We received several suggestions about how we might strengthen the effectiveness of compliance roles, both in terms of structure and how the roles are carried out in practice. However, there was also some caution about the potential impacts of any changes on sole practices and small firms.

Similarly, we heard some stakeholders calling for more monitoring and checks on firms that significantly change their profile, particularly through the acquisition of other firms. Some pointed to potential areas of concern. Issues highlighted included smaller firms buying bigger firms. And where a firm buys another firm of a very different sort and takes on different areas of law, including areas where there are traditionally large amounts of client money held. Some pointed to tighter controls in operation in other sectors. However, some stakeholders warned against introducing checks that might unnecessarily slow down or dampen normal market behaviour, saying the benefits from a dynamic market are more common than risks.

Our research into emerging market developments highlighted a changing sector. We must continuously improve our data and capability to understand developments, and properly identify, assess and act on risks. For example, the research highlights increasing merger and acquisition activity. While this may be positive, an expanding firm that then fails - for example because of poor management or fraud - could result insignificant harm to more consumers. Our own proactive visits found no concerns with the accumulator model or acquisitions per se but identified that potential risks may arise from issues such as lack of capacity and expertise to successfully integrate people, systems and processes.

Compensation Fund

There was strong support for the compensation fund across the breadth of stakeholders that we spoke to. There was very little enthusiasm for reducing the existing eligibility and scope. Consumers favoured universal coverage, irrespective of wealth. Currently, individuals, small businesses and small charities can call upon the fund, as a last resort, if they have lost money because of the dishonesty or unethical actions of a solicitor.

In terms of contributions, it was largely accepted among solicitors that the whole profession benefited from the fund as it helped uphold its reputation. Some suggested that we should explore variable contributions based on factors such as risk, impact, size or turnover. Our data shows that although most of our interventions are into small firms, when we do intervene into large firms, the value of compensation fund claims is higher than the totality of those relating to small firms.

The research looking at other jurisdictions highlighted that there is lawyer theft and misappropriation in all jurisdictions where they have unfettered access to client money. Most cases are small and relate to mismanagement but there are examples of claims resulting from large-scale criminality. The majority of compensation schemes are funded by individual lawyer contributions. The research highlights one example of the level of contribution being weighted towards those that hold more client money. Our Compensation Fund is made up of annual contributions from all solicitors (except those employed by the Crown Prosecution Service) and firms that hold client money. Contributions are set on a flat fee basis. Contributions are currently split 50/50 between individual solicitors and firms.

Next steps

The consultation will be open until 21 February 2025. We will also be carrying out a series of engagement events.

It is important that we hear from you about the likely effectiveness of the propositions, the impacts that they might have and, if we proceed with them, how they might be developed to maximise the potential benefits while avoiding unintended consequences.

Who we have heard from already

Since launching the consumer protection review in February, we have gathered wide-ranging feedback and views from our stakeholders:

- Over 200 stakeholders attended 14 roundtable events or discussions with us. These included the legal profession, the finance and tech sectors, compliance professionals and three consumer representative

group events.
- 31 members of the public participated in four focus groups.
- A diverse group of 39 consumers collectively spent 350 hours giving us their in-depth views on consumer protections through a process of 'deliberative research'.
- We also gained insights from online polling conducted with 2,000 members of the public.
- We received written responses to our consumer protection review discussion paper [https://qltt.sra.org.uk/sra/consultations/discussion-papers/consumer-protection-review/] from over 20 stakeholders.
- We also commissioned research into how other jurisdictions and regulators manage client money and compensation funds, and future risks in the legal sector. The commissioned research has been published in full alongside this consultation.

Consultation part three: Delivering and paying for a sustainable compensation fund

This is one of three separate but related consultation pages which together form the next stage of our review into Client money in legal services: safeguarding consumers and providing redress.

Introduction

The Compensation Fund (the Fund) plays a crucial role in maintaining public trust and confidence in legal services. It provides consumers with a safety net when things go wrong and it benefits solicitors and firms by safeguarding the reputation of the profession as a whole. The potential liabilities of the Fund are changing, with increasing numbers of claims on the Fund. In 2022/23, we saw the highest number of interventions in recent times with 65 interventions.

At the same time, we are seeing an increase in the number and size of failing firms. During the 2022/23 financial year the fund was impacted by two very large interventions, into Metamorph in November 2022 and Axiom Ince in October 2023. During the year to 31 October 2023 grants were made to the value of £41.1m (while total contributions amounted to £10.3m). The average annual amount of payments from the Fund between 2010 and 2022/23 was £29m.

Throughout our engagement programme on the review, we have heard widespread and strong support for the Fund from the profession, consumer groups and the public. Stakeholders felt that providing a remedy for consumers who suffer financial loss due to dishonesty, failure to comply with insurance requirements, or failure to account for client money is essential for maintaining trust in, and the credibility of, the profession.

In light of recent increases in the number of interventions, the range of consumers affected and the value of claims, the protections offered by the Fund are more important than ever. The two very large interventions that took place in November 2022 and October 2023 involved exceptionally high numbers of consumers and high-value claims.

This part of our consultation is an opportunity for us to hear from you as we consider possible changes we could make to the Fund and the way it operates. In the next section, we outline how the Fund operates currently. In the following sections, we have separated our thinking into two parts. The first focuses on how we set the contribution levels for those who pay into the Fund and the second looks at the ways we allocate grants from the Fund to reimburse consumers.

Some of the discussion that follows is necessarily high-level at this stage, as we are still developing our own thinking on some of the key questions relating to the future operation of the Fund. Responses to this consultation will inform more detailed proposals for further consultation in the future. However, we also consider that there are some specific changes to the way we apportion contributions to the Fund which could be progressed more quickly. On this, we have included specific proposals, which we would like to test through this consultation.

Proposals and Ideas for Consultation

Open all [#]

The Compensation Fund: current arrangements

The Fund is a safety net designed to protect consumers when money has been stolen or not been accounted for by someone we regulate or when a regulated person should have had insurance in place to cover a loss but did not. It is a discretionary fund [https://qltt.sra.org.uk/consumers/compensation-fund/resources/exercising-discretion-payment/]. This means that no one has a right to receive a payment from the Fund, and when we do decide to make a payment, the amount of that payment may not always replace all the money lost. The Fund is also a fund of last resort, which means that we may ask applicants to exhaust all other options to recover lost money before we consider their application.

The Fund also covers the costs of our interventions into firms to protect client interests and money. This includes administrative costs, for example, paying for staff who deal with applications to the Fund, as well as the handling and storage of client files.

The Fund is made up of annual contributions from all firms that hold client money and all solicitors with a practising certificate (except those employed by the Crown Prosecution Service who are specifically exempted from paying a contribution by s36A(4) of the Legal Services Act 1974 [https://www.legislation.gov.uk/ukpga/1974/47/part/II/crossheading/intervention-in-solicitors-practice-compensation-fund-and-professional-indemnity]). Contributions are set on a flat fee basis. Contributions are currently split 50/50 between individual solicitors and firms. Many firms choose to pay the individual contributions on behalf of the solicitors they employ, which increases the financial burden on many larger firms.

We set contribution levels every year taking into account the Compensation fund contribution level principles [https://qltt.sra.org.uk/mysra/fees/compensation-fund-contribution-level-principles/#:~:text=The%20principles,-Principle%20one%20-%20The&text=The%20compensation%20fund%20is%20a%20key%20consumer%20protection%20for%20people,a%20level%20of%20unant :

- the overriding principle is to maintain the viability of the Fund
- we will ensure that the professional contributions to the Fund are as manageable as possible for those we regulate
- we will collect the contributions to the Fund in a way that is manageable for those we regulate
- we will be transparent about the Fund monies and their management.

More detail about the contribution level principles is available on our website [https://qltt.sra.org.uk/mysra/fees/compensation-fund-contribution-level-principles/] .

Contribution levels are set annually based on calculations which take into account the levels of claims and expected grant payments by looking at historic trends and other relevant information, such as knowledge of any potential significant interventions in the coming year and the level of reserves in the Fund.

Our Compensation Fund Rules [https://qltt.sra.org.uk/solicitors/standards-regulations/compensation-fund-rules/] set out how we operate the Fund, including eligibility criteria.

Currently, individuals and small businesses and charities with an annual turnover of less than £2m can apply to the Fund when they have lost money. We do not limit claims based on individual wealth, but our guidance [https://qltt.sra.org.uk/consumers/compensation-fund/resources/] states that we may refuse or reduce claims for 'exceptionally wealthy' claimants who will 'suffer no material hardship' if the claim is not met. We also take into account the extent to which a claimant may have contributed to their own loss.

We consulted in detail on our eligibility criteria in our 2020 consultation, Protecting users of legal services - prioritising payments from the SRA Compensation Fund [https://qltt.sra.org.uk/sra/consultations/consultation-listing/comp-fund-reform-2020/] . We also explored eligibility with stakeholders and through in-depth research with consumers in preparation for this consultation and there was little support to tighten eligibility. Some stakeholders felt that the discretionary nature of the Fund already allows us to make decisions about applications to the Fund. Participants in our consumer in-depth research and stakeholders also felt that protections should apply to all consumers regardless of their personal circumstances, the amount of money lost, or the legal service used. We have decided not to propose any changes to the eligibility criteria at this time beyond considering a rule change to explicitly exclude claims related to speculative investments.

Through this consultation, we are seeking views on proposals to change the apportionment of contributions to the Fund and on alternative ideas for the longer term, such as moving to differential contributions based on turnover or the amount of client money held. We introduced some of these ideas in our discussion paper (February 2024) [https://qltt.sra.org.uk/sra/consultations/discussion-papers/consumer-protection-review/] and discussed them with stakeholders in high-level terms during our extensive engagement exercise.

In addition, we need to respond to the Legal Services Board's expectations which they set out in their decision notice approving our application for Compensation Fund contributions for 2024/25 (September 2024 [https://legalservicesboard.org.uk/wp-content/uploads/2024/09/SRA-Compensation-Fund-Decision-Notice.pdf]). These included that we would reconsider 'the structure of the contribution between individuals and firms and the efficacy of a turnover-based approach within the consumer protection review.'

In parallel with this consultation, we will be working on other aspects of the Fund, including reviewing and updating the methodology used to calculate the required level of reserves for the Fund.

Contributions to the Fund - options

In this section, we want to explore and invite your views on short and long-term options for setting Fund contributions. In the short term, we are proposing changing the 50/50 split between firms and individual solicitors. Changing the apportionment of Fund contributions is a change that we can operationalise quickly, in time for setting contributions for 2025/26, should we choose to proceed with the proposal following consultation.

We also want to take the opportunity now to explore and get your views on whether we should make more fundamental changes to the methodology we use in calculating Fund contributions, moving away from a flat fee model to differential contributions. These proposals are long-term in nature and are high-level at this point in time.

Apportionment of contributions

The two high-profile interventions into Axiom Ince and Metamorph, in conjunction with an increase in number of smaller interventions, have had an exceptional impact on the Fund. As a result, we have had to make significant increases to the contribution levels for individuals and firms for 2024/25. Table 1 sets out the annual contributions since 2018/19 and shows the significant increases for 2024/25.

Table 1: Compensation Fund contribution levels

Practising year	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Individual contribution	£90	£60	£50	£40	£30	£30	£90
Firm contribution	£1,680	£1,150	£950	£760	£690	£660	£2,220

The total contribution to the Fund is divided 50:50 between the contributions of regulated individuals and firms. This was set in 2010 and reflected the composition of the sector at the time. The composition of the sector has changed since the 50:50 split was set; the number of individual solicitors [https://qltt.sra.org.uk/sra/research-publications/regulated-community-statistics/data/population_solicitors/] has increased significantly while the number of firms has decreased. This means that there are fewer firms paying their 50% 'share' of Fund contributions now than in 2010, increasing the burden for those that remain. This could disproportionately impact small firms and, in particular, those firms operating in less profitable but vital consumer facing areas of practice.

In our equality impact assessment on the Fund contribution for 2024/25 [https://legalservicesboard.org.uk/wp-content/uploads/2024/08/SRA-Compensation-Fund-Part-3-of-Schedule-4-Application-August-2024-For-Submission-to-LSB.pdf], we identified that the significant increases to the contributions required could disproportionately impact small law firms who are least able to manage large increases. We also noted that there are specific equality impact considerations in respect of small firms, in that Black and Asian solicitors, solicitors from lower or intermediate socio-economic backgrounds, solicitors aged 45 and upwards and disabled solicitors are overrepresented in small firms.

For these reasons, we think that the time is right to reconsider the split between individuals and firms. In particular, we are considering increasing the proportion raised by individual contributions and reducing the proportion raised from firms.

Using a 70/30 (individual/firm) split for setting contributions for 2025/26 is the option which best adjusts for the changing composition of the profession. This split would mean that the percentage increase in contributions from firms and individuals since 2010 would be similar and we therefore feel this is the most appropriate option. We recognise that it would mean individuals altogether contributing a larger proportion to the Fund overall but given the significant increase in the number of individuals and the fall in the number of firms, we feel this is proportionate.

Table 2 below illustrates the contribution levels of individuals and firms under alternative apportionments. The figures are based on a total Fund amount of £14.2m, the average that would have been required over the previous five years to maintain the balance in the Fund. Other assumptions are that all solicitors with a practising certificate (except those that work for the Crown Prosecution Service who are exempt) continue to pay and all firms that hold client money continue to pay.

Table 2: Contributions to the Fund: alternative apportionments

Note 50/50 split represents the current approach

Individual proportion	Firms proportion	Individual contribution (£)	Firm contribution (£)
50%	50%	40	1,075
60%	40%	48	860
70%	30%	55	662

One of the Fund contribution level principles commits us to ensuring that contributions are as manageable as possible for those we regulate. We think that the proposed increases for individuals shown in our modelling are consistent with this principle. However, in assessing the responses to this consultation, we will need to consider potential impacts on individual solicitors since they will be paying a greater proportion toward the Fund as a cohort than under the previous 50:50 split. It will be important to understand how this change could impact individuals in a wide range of circumstances, including those working in-house, solicitors working in sectors where earnings might be lower.

At the same time, the reduction in the level of firm contributions would be beneficial to smaller firms and those operating in less profitable areas of work who, as we noted earlier, can be disproportionately impacted by large increases in contribution levels. Similarly, any reduction in firm contributions would have a positive impact on those groups who are overrepresented in smaller firms [https://qltt.sra.org.uk/sra/equality-diversity/diversity-profession/diverse-legal-profession/].

Questions

Q1. Do you agree that changing the apportionment of Compensation Fund contributions to 70% individuals and 30% firms is an appropriate and proportionate approach to setting contribution

levels for 2025/26? Please give reasons for your answer.

Q2. Are there any other important apportionment issues you think we have not considered here? If so, please explain what they are.

Differential contributions

Beyond the more immediate question of whether to reapportion contributions between individuals and firms examined above, we would like to explore for the longer term the case for alternative models for determining and possibly differentiating the level of contribution firms should make. At present, all firms holding client money pay a flat rate contribution towards the Fund set on an annual basis, irrespective of the size and profile of the firm and the amount of client money held. The current approach has a number of advantages:

- simplicity, in that all firms pay the same amount which avoids complex calculations and potential disagreements between firms and the SRA on the contribution amount owed;
- clarity, in that firms know where they stand and the SRA has a clear basis for assessing the amount which can be collected in contributions;
- feasibility, in that the current arrangements are well-established, understood and do not require process changes by us, firms or solicitors.

However, we recognise there may be valid and persuasive arguments for moving away from a flat contribution for firms. Our own initial analysis and engagement with stakeholders so far has identified a range of possible alternative ideas, which are explored further below. We are not making any proposals to move to a model of differential contributions for firms at this time, rather, we are taking this opportunity to explore some initial ideas. Any move from the current flat rate model to a differential approach would inevitably produce 'winners and losers' in comparison with the existing arrangement. We welcome views on whether one or more of these would represent a more effective and viable mechanism for ensuring contributions to the Fund are appropriate and manageable and that the Fund remains sustainable.

Enhanced Requirements

One approach would be to preserve the basic flat fee contribution structure but offer a discount to firms on the amount payable to the Fund, subject to meeting certain specified criteria or enhanced requirements. These could include indicators such as a firm employing external auditors or having certain accreditations, for example for cyber security. This could incentivise firms to take positive actions to reduce risk, better protecting both consumers from potential losses and the Fund from pressures. This may go some way to addressing concerns that 'low risk' firms subsidise those who pose a higher risk.

However, the viability and efficacy of this approach would crucially depend on whether it is possible to arrive at a practical set of enhanced requirements which are commonly understood and accepted as reducing the actual incidence of risk. A system of enhanced requirements could be complex to administer and could result in higher operational costs for firms, even if their Fund contributions were reduced.

It is likely that larger, wealthier firms would be the most able to meet the enhanced requirements, while smaller firms may struggle to do so due to resource or financial constraints. This could mean that smaller firms are more likely to see an increase in their contribution levels.

Risk Categorisation

Another alternative approach would be to vary contributions to the Fund based on risk categories assigned to each firm. Again, the efficacy of this approach would crucially depend on whether we could establish a commonly agreed and understood assessment of risk indicators. These indicators could, for example, include:

- regulatory history (previous breaches, complaints, past interventions)
- practice areas (we know that areas such as conveyancing or personal injury may pose higher risks)
- financial stability (firms in financial difficulties may be more likely to take risks)
- firms' internal risk management systems (having policies and processes in place to mitigate risk)
- staff turnover and training.

Firms identified as posing a higher risk to the Fund and to consumers would pay more while firms identified as lower risk would pay less, addressing some concerns that 'low risk' firms subsidise those who pose a higher risk. This approach may also incentivise firm-led risk reduction, reducing the overall risk to consumers.

We are aware that there could be wider implications of moving to risk-based models. For example, offering certain legal services categorised as higher risk may become less attractive for firms, which may in turn impact the accessibility of services in those areas.

In addition, as set out in recent research (PDF 73 pages, 1.4MB) [https://qltt.sra.org.uk/globalassets/documents/sra/research/econometric-analysis-of-solicitors-pii.pdf?version=4a5ff5] into professional indemnity insurance costs for legal service providers, when setting premiums, insurers risk assess firms. Insurers consider firms' type of work, whether they hold high or variable amounts of client money, their history of regulatory findings and number of fee earners. Categorising firms by risk would therefore mirror the approach already taken by insurers but may lead to premiums increasing for some firms if insurers began to

take into account our risk categorisation. This may again lead to less supply and accessibility of services in certain areas.

We are concerned that devising, agreeing, and assessing risk levels for firms would be challenging and could increase regulatory requirements and costs on firms, again potentially impacting smaller firms and sole practitioners due to lack of resource. It may be that any attempt to create this sort of model would ultimately be a proxy, and potentially not very accurate. Decisions on risk categorisation could be challenged by firms, making this a complicated and possibly lengthy process.

Amount of Client Money Held or Annual Turnover of Firms

Other alternative methods for setting differential contributions might be to use either the amount of client money held by the firm or by using the firm's turnover.

One approach would involve setting contributions to the Fund based on the amount of client money held by a firm, so that firm contributions to the Fund would increase in line with the amount of client money held. The more client money held by a firm, the higher the Fund contribution. Contributions could be based on the maximum amount of client money held at any point during the previous year (based on the latest reported data), or the average amount of client money held during the same period of time.

Setting contributions based on the amount of client money held would have the advantage of simplicity for us and for firms. We already collect the data required and so we would not place an additional administrative burden on firms. This approach may disincentivise holding client money and may increase the use of alternatives such as Third Party Managed Accounts (TPMAs) particularly amongst larger firms. Those firms which use TPMAs and do not hold client money in their accounts are currently exempt from making firm contributions to the Fund.

SRA guidance on the use of TPMAs states [https://qltt.sra.org.uk/solicitors/guidance/third-party-managed-accounts/] 'Money held in a TPMA does not fall under the definition of client money in the SRA Accounts Rules [https://qltt.sra.org.uk/solicitors/standards-regulations/accounts-rules/] (the Accounts Rules) as it is not held or received by you. As such it does not have to be held in accordance with our rules relating to the holding of client money.'

The number of firms holding client money has been reducing year on year. In part 1 of this consultation (Holding client money) [https://qltt.sra.org.uk/sra/consultations/consultation-listing/holding-client-money/], we indicate our interest in exploring moving away from firms holding any client money. If this does happen at some future point in time, we would need to develop an alternative method for setting Fund contributions.

A system where firms and solicitors do not hold client money has the potential to mitigate the risk of loss for consumers and reduce liabilities on the Fund. But protection for consumers in the form of the Fund would still be required, as the risk of losses cannot be entirely eliminated. For example, there would still be some risks of money being misdirected and other losses covered by the Fund which do not relate to client money.

Another approach for setting differential contributions to the Fund could be linked to firms' annual turnover as reported to us. The higher the turnover, the bigger the contribution to the Fund. Setting firm contributions based on turnover might better reflect the potential impact of an intervention on the Fund. Most Fund claims follow an SRA intervention and most interventions and claims relate to sole practitioners or small firms. However, where a large firm is intervened into, the impact on the Fund in terms of the costs of the intervention, numbers of clients and value of claims is likely to be much greater.

Our internal data shows that since January 2017, 72% of all interventions have been into small firms, sole practices or freelancers. Sole practice firms alone made up 42% of all interventions. Conversely, by volume, 'large' or 'very large' practices only account for 3% of interventions overall. At its peak (2022/23), this figure rose to 9%.

However, our data show that because of the number of consumers affected and the amount of client money held, relatively small increases in the number of interventions into larger firms are likely to cause a disproportionate increase in payments required from the Fund. For example:

- in 2019/2020, the top 1,000 SRA regulated firms by turnover accounted for just one intervention (3%), but this one intervention accounted for 71% of payments made by value
- in 2022/23, there were 6 interventions into this cohort (9% of all interventions) but 74% of payments made by value related to these interventions.

A contribution model based on turnover has the advantage of simplicity for us and firms. We already collect the data required and so we would not place an additional administrative burden on firms.

For both options – differentiating contributions by turnover or amount of client money held – there will be additional considerations required when calculating the contribution amounts. This will include considerations around minimum contributions, caps on contribution levels and using banding. It is crucial that we consider the impacts of any of these changes on firms and the implementation costs and lead times for us. We will further develop our thinking and set out our consideration of these issues in future consultations. For now, we are keen to get your views on our current thinking about possibly setting differential contributions.

Questions

Q3. What are your views on the possibility of setting differential contribution levels for different firms?

Q4. What are your views on the possible alternative methods of setting differential contributions to the Compensation Fund (based on enhanced requirements, risk categorisation, the amount of client money held, or annual turnover)?

Q5. Are there other alternative approaches to differential contributions you think we should consider?

Payments from the Compensation Fund

Ensuring appropriate consumer protection and the sustainability of the Fund is a priority for us. In this section, we want your views on a range of options when looking at the way the Fund deals with applications from consumers.

Participants in our in-depth consumer research developed a set of five guiding principles they felt were essential for a system of consumer protections to be fit for purpose and consumer-centric. These principles were:

- equitable treatment,
- timeliness,
- simplicity,
- transparency, and
- protecting the Fund.

Equitable treatment was considered the most crucial principle. We have used these principles to help develop our thinking on the options below.

Individual claims

Individual claims on the Fund are capped at £2m. We have discretion to pay a claim above this amount, which we have used once in recent years. Since July 2022, we have made 171 payments of more than £100,000, 12 payments of more than £500,000 and 4 payments over £1m. However, the average payout is around £40,000 and a typical claim is around £5,000.

Our commissioned research into alternative consumer compensation fund models [https://qltt.sra.org.uk/sra/research-publications/how-regulators-jurisdictions-manage-consumer-compensation/] indicates that our cap compares favourably. As the data from previous claims shows, the cap could be lowered without severely impacting most claimants. At the same time, given the small numbers of higher value claims, a lower cap would only result in a limited reduction in the liabilities of the fund whilst having a significant negative impact on the small number of consumers with high value claims.

Previously, we have considered lowering the cap for individual claims from £2m to £500,000. This proposal formed part of a wider consultation we undertook in 2020. There was little support for the proposal, mainly because it would reduce consumer protection. We only identified a limited benefit in terms of protecting the viability of the Fund from reducing the cap for individual claims, while, at the same time, there was a real potential for significant impacts on a small number of consumers. In light of this, we decided not to proceed with this proposal.

We do not think that the circumstances around individual claims on the Fund have changed significantly since our previous consultation in 2020 and we feel these arguments are still relevant, so we are not proposing to make any changes to the cap for individual claims at this time. We have heard the views of stakeholders and the public on the limit for individual claims and they align with this approach. Reducing the maximum individual payout was unpopular across our engagement activities. Stakeholders told us that reducing consumer protections could undermine public confidence in the profession.

Cap for connected claims

Under our Compensation Fund Rules, we can apply a discretionary £5m overall cap (the connected claims cap) on claims that relate to the same or connected underlying circumstances – we call this the 'connected claims cap'. To date, we have never applied the cap.

We introduced the connected claims cap in the context of rising claims associated with potential investment scheme fraud at that time, risking the viability of the Fund. However, the majority of claims on the Fund relate to probate, conveyancing and personal injury. Our Rules also enable us to refuse claims where 'the loss arose in a speculative enterprise offering very high returns but carrying a commensurate level of risk.'

We have only considered using this cap once in the last 24 months, in relation to Axiom Ince. We decided not to apply the cap due to the overall scale of consumer loss and the risk that applying the cap could lead to an unacceptable reduction in public trust and confidence in solicitors.

A key issue with the cap is its rigidity. We have a binary choice of whether or not to apply the cap at £5m, we could not for instance choose to apply a higher cap. Our experience of dealing with linked claims associated

with Axiom Ince indicates that a fixed cap on connected claims is particularly challenging in circumstances where there are exceptional numbers of consumers impacted and / or large sums of money lost.

There are also challenges in applying any cap when dealing with connected circumstances. These include, for example, dealing with time-critical emergency situations such as conveyancing transactions due to complete within days of an intervention, and how we assess claims when we are uncertain as to the final amount of claims we will receive and the amount that we will recoup through statutory trust and insurance.

As part of our review, we have been considering alternative options for dealing with connected claims. Members of the public taking part in our consumer in-depth research saw equal treatment as being very important. They consistently felt that consumers should be fully reimbursed, regardless of factors such as being part of a connected claim or if there were to be inadequate funding available. If providing everyone with a full refund was not possible, they felt strongly that all consumers should be treated equally, for example, each person being reimbursed an equal percentage of their loss. Consumers also wanted as much certainty and transparency as possible. They wanted to be able to begin a legal transaction knowing what protection would be in place should anything go wrong.

Taking into account what we heard through the consumer in-depth research and wider stakeholder engagement, we have considered a number of options:

- setting a flexible cap for connected claims,
- removing the cap for connected claims,
- guaranteeing reimbursement up to a specified amount.

Below we present some high-level thinking about these options and would like to take this opportunity to get your views on them to inform our thinking further.

A flexible cap for connected claims

A possible option is to have a flexible cap for connected claims, which provides some parameters, but still allows us to determine a bespoke cap in response to particular circumstances. For example, we could specify through a flexible cap:

- the maximum total amount the Fund would pay in respect all of the connected claims;
- the minimum amount of compensation that each successful claimant would receive, and/or
- the minimum percentage of their loss that each successful claimant would receive.

We would need to further consider the level of flexibility of the cap and balance the need to provide clarity of protection for consumers with the importance of maintaining the viability of the fund. We may consider establishing a set of parameters as principles to be considered when determining the cap or alternatively they could be set based entirely on the circumstances. Although it is important that any flexible cap would still be subject to the existing Fund rules and its overriding discretionary status.

If the flexibility was to be entirely dependent on the circumstances that arose, we would determine the bespoke cap that would apply to those circumstances. For example, we may decide to limit the total amount paid to £10m, or we may decide that each successful claimant will receive a minimum of 50 per cent of their loss.

Under this scenario, consumers who made a successful claim to the Fund would receive some recompense but some or all may not receive full reimbursement for their losses. This would provide some protection for the Fund but could reduce consumer protection.

This option would provide us with greater flexibility to be responsive to specific circumstances, helping us to maintain reserves in the Fund and reduce the likelihood of contributions levels fluctuating. This could be a benefit to smaller firms and sole practitioners who are less financially resilient or work in less profitable areas. However, this option would not eliminate the possible need for an in-year levy.

For consumers, this approach would provide some certainty and transparency as there would be clear parameters set for any connected claims cap. However, because a bespoke cap will necessarily vary depending on the circumstances, it might not be seen as sufficiently transparent or certain. Participants felt that a lack of transparency and certainty around compensation would mean that they would not be making an informed choice about how much money they entrust to a firm.

This approach would also potentially limit the compensation consumers receive below the amount lost. Participants in our consumer in-depth research felt that any connected claims cap would result in consumers losing out on full reimbursement through circumstances over which they have no knowledge or control, for example, if they were part of an exceptionally large cohort of consumers who lost money because of the ethical failures of one firm.

As a flexible cap would be situation-specific, there would be a possibility that some clients could receive more compensation than others, which was perceived negatively by participants in our consumer in-depth research.

Removing the cap for connected claims

We have learned from our consumer in-depth research that, when weighing up the application of a cap versus accepting a risk of rising contributions impacting on the cost of legal services, consumers would choose not imposing a cap. Participants noted that they would have no knowledge of, and no control over, how many other consumers are connected to a claim and thought this should not be a factor in how much compensation they receive. They felt that removing the cap would create a more transparent system of redress for consumers. In addition, they were willing to pay a little extra to ensure that any of their money being held or processed by a firm would be kept safe and that they would receive all their money back.

However, participants also understood the importance of protecting the Fund and this was one of the 5 key principles they felt should be at the centre of effective consumer protections.

Having no cap on connected claims would increase the vulnerability of the Fund as potential liabilities would not be limited. Our existing discretion and eligibility criteria would assist us, as they do now, in disqualifying some claims on the Fund and the option remains to impose an in-year additional Fund contribution to address any unusually high-cost interventions.

Guaranteeing compensation up to a specified amount

Under this approach, in circumstances where there is a high volume of connected claims, we would guarantee to pay consumers up to a specified set amount for each claim. We could determine the amount in a number of ways which would require further analysis. For example, we could set an amount according to the legal service used such as conveyancing or probate or set an amount based on the average value of previous claims.

In our consumer in-depth research, however, we heard that it was important to participants that any approach to compensation treat all consumers equally, regardless of their personal circumstances, or legal service used. At the same time, participants felt that transparency and certainty were also important features of consumer protection arrangements and we think this option would provide that. Participants in our in-depth research were also familiar with similar schemes operated in other sectors, such as the Financial Services Compensation Scheme, which compensates up to £85,000 per eligible person, per bank, building society or credit union.

We are interested in your views on the range of potential options discussed above. We would particularly like to hear views on how well or otherwise the various options we have outlined would:

- protect consumers;
- maintain the viability of the Fund;
- keep contributions manageable
- provide a degree of certainty about payouts from the Fund, and therefore future contribution levels.

Questions

Q6. To what extent do you agree we should move away from the current arrangements that allow us to impose a cap of £5m for connected claims?

Q7. Would you support any of the other options discussed (a flexible cap for connected claims, removing the cap for connected claims, guaranteeing compensation up to a specified amount)? Please explain why.

Q8. Are there other important considerations you think we have not considered here? If so, please explain what they are.

Amending our Compensation Fund Rules to exclude specific claims

We want to explore whether it would aid transparency for consumers if we add to the Compensation Fund Rules to provide greater clarity on the criteria for excluding claims.

Transparency was one of the five key principles that participants in our consumer in-depth research agreed were crucial characteristics of consumer protections. This was linked to the importance they placed on the Fund being easy to understand and accessible for consumers, given that the circumstances in which they make a claim are necessarily times of high stress and anxiety for consumers.

We commissioned research into alternative consumer compensation fund models [https://qltt.sra.org.uk/sra/research-publications/how-regulators-jurisdictions-manage-consumer-compensation/] . This research found that many compensation schemes operating in other jurisdictions have responded to increased risk from investment and property speculation by tightening their rules to exclude claims arising from financial or investment services and mortgage financing.

We already use our discretion [https://qltt.sra.org.uk/consumers/compensation-fund/resources/exercising-discretion-payment/] to refuse or limit payments of claims in certain circumstances, or in relation to particular types of applicant or loss. For example, we have used this discretion in the past to exclude or reduce claims associated with high-value investment schemes in circumstances where the work did not fall within the usual business of a solicitor, or the applicant had contributed to the loss.

We could amend the Compensation Fund Rules to exclude claims associated with speculative investments. This could provide additional clarity for consumers. We have previously identified high-risk investment schemes

[https://qltt.sra.org.uk/solicitors/guidance/investment-schemes-including-conveyancing/] as representing a risk to consumers and the Fund. The option of a £5m cap on connected claims was introduced in 2021 as a potential mitigation.

We are seeking your views in this consultation on whether there are specific types of claim that we should explicitly exclude from being covered by the Fund.

Questions

Q9. What are your views on the idea of amending our Compensation Fund Rules to explicitly exclude specific types of claims? If you think specific types of claim should be excluded, which ones are these?

Q10. Are there any other considerations we should take into account in relation to payments from the Compensation Fund? If so please explain what they are.

Q11. In the context of this consultation, do you agree with our assessment of equality, diversity and inclusion considerations in our impact assessment? If not, what else do you think we should consider?

Equality impact assessment

We have produced a draft initial equality impact assessment Consumer Protection Review consultation (PDF 15 pages, 242KB) [https://qltt.sra.org.uk/globalassets/documents/sra/consultations/2024/draft-initial-equality-impact-assessment-consumer-protection-review-consultation.pdf] , covering all three parts of the Client money in legal services: safeguarding consumers and providing redress consultation.

Consultation questions

Q1. Do you agree that changing the apportionment of Compensation Fund contributions to 70% individuals and 30% firms is an appropriate and proportionate approach to setting contribution levels for 2025/26? Please give reasons for your answer.

Q2. Are there any other important apportionment issues you think we have not considered here? If so, please explain what they are.

Q3. What are your views on the possibility of setting differential contribution levels for different firms?

Q4. What are your views on the possible alternative methods of setting differential contributions to the Compensation Fund (based on enhanced requirements, risk categorisation, the amount of client money held, or annual turnover)?

Q5. Are there other alternative approaches to differential contributions you think we should consider?

Q6. To what extent do you agree we should move away from the current arrangements that allow us to impose a cap of £5m for connected claims?

Q7. Would you support any of the other options discussed (a flexible cap for connected claims, removing the cap for connected claims, guaranteeing compensation up to a specified amount)? Please explain why.

Q8. Are there other important considerations you think we have not considered here? If so, please explain what they are.

Q9. What are your views on the idea of amending our Compensation Fund Rules to explicitly exclude specific types of claims? If you think specific types of claim should be excluded, which ones are these?

Q10. Are there any other considerations we should take into account in relation to payments from the Compensation Fund? If so please explain what they are.

Q11. In the context of this consultation, do you agree with our assessment of equality, diversity and inclusion considerations in our impact assessment? If not, what else do you think we should consider?

Consultation documents

- Consultation: Client money in legal services safeguarding consumers and providing redress - Delivering and paying for a sustainable compensation fund (PDF 23 pages, 310KB) [https://qltt.sra.org.uk/globalassets/documents/sra/consultations/2024/client-money-in-legal-services-safeguarding-consumers-and-providing-redress---delivering-and-paying-for-a-sustainable-compensation-fund.pdf?=2024-11-21]
- Client money consumer protection arrangements [https://qltt.sra.org.uk/sra/research-publications/client-money-consumer-protection-arrangements/]
- Consumer polling: Summary of consumer research conducted to inform the SRA's consumer protection review [https://qltt.sra.org.uk/sra/research-publications/consumer-polling/]
- Draft initial equality impact assessment Consumer Protection Review consultation (PDF 15 pages, 242KB) [https://qltt.sra.org.uk/globalassets/documents/sra/consultations/2024/draft-initial-equality-impact-assessment-consumer-protection-review-consultation.pdf]
- Future market changes in the legal sector and their potential impact on client money [https://qltt.sra.org.uk/sra/research-publications/future-market-changes-legal-sector-client-money/]

- How other regulators and jurisdictions hold client money [https://qltt.sra.org.uk/sra/research-publications/regulators-jurisdictions-hold-client-money/]
- How other regulators and jurisdictions manage consumer compensation funds [https://qltt.sra.org.uk/sra/research-publications/how-regulators-jurisdictions-manage-consumer-compensation/]

Consultation responses

- Summary of responses - Client money in legal services – safeguarding consumers and providing redress: Delivering and paying for a sustainable compensation fund (PDF 13 pages, 250KB) [https://qltt.sra.org.uk/globalassets/documents/sra/consultations/2024/summary-responses-feedback-consultation-questions-contributions-compensation-fund.pdf]
- Responses to Client money in legal services – safeguarding consumers and providing redress: Delivering and paying for a sustainable compensation fund (PDF 16 pages, 225KB) [https://qltt.sra.org.uk/globalassets/documents/sra/consultations/2024/consultation-responses-to-questions-contributions-compensation-fund.pdf]

Back to closed consultations [https://qltt.sra.org.uk/sra/consultations/consultations-closed/]