

Compensation fund contribution level principles

20 October 2020

Introduction

The compensation fund is a discretionary fund of last resort, established some 70 years ago to protect the users of legal services. It supports public confidence in solicitor firms and the reputation of the profession.

It is important that we maintain the viability of the compensation fund to make sure it remains a key consumer protection for people accessing regulated legal services. This means that the fund must be sufficient to meet future demand while not imposing unnecessary financial burdens on the profession which funds it, the cost of which is ultimately passed onto consumers.

As part of our commitment to increased transparency and accountability, and following our consultation [<https://www.sra.org.uk/sra/consultations/consultation-listing/business-plan-2020-21/?s=c>] alongside our Business Plan 2020/21, we are publishing the principles that our Board will consider when setting the level of compensation fund contribution levels in the future.

Background

The compensation fund contribution level principles should be read alongside the compensation fund Rules [<https://www.sra.org.uk/solicitors/standards-regulations/compensation-fund-rules/>] which set out how the fund operates. The fund requires both regulated individuals and regulated firms to make an annual contribution, collected during the practising renewals period.

There is no legal right to a grant from the fund. These are discretionary and are limited to certain types of loss, namely where:

- a. those for whom services are provided have lost money as a result of their solicitor or firm's dishonesty
- b. the solicitor or firm has misappropriated or otherwise failed to account for their money, or
- c. 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.

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. And, as its costs are ultimately reflected in the price of services, it is important that our policy and rules in this area make sure that:

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

Every year, our Board carefully considers and sets the contribution from the profession to the compensation fund. The contributions fund the costs of claims, reserves and the costs of handling the claims themselves, including interventions into firms where client monies and files are at risk.

The annual contribution level is informed by reviewing past claim levels, significant prospective claims and any trends, making assumptions on volumes and extrapolating historical data to forecast future receipts and payments. This includes looking at data relating to interventions, although it is difficult to estimate future claims against, or amounts recovered from, interventions in progress.

In order to support the transparency of our decision making, we are setting out the four general principles that the Board considers when setting the annual contributions to the compensation fund.

Overall, these principles taken together are designed to make sure we balance the need to maintain the viability of the fund with the need for contributions from the profession - the costs of which are ultimately passed onto consumers - to be proportionate.

The principles

Principle one - The overriding principle will be to maintain the viability of the fund.

The compensation fund is a key consumer protection for people accessing regulated legal services, so it must be financially sustainable. This means that the fund must be, first, sufficient to meet anticipated future demand and to manage a level of unanticipated claims. Second, it must be maintained at a level that does not place unnecessary financial burdens on the profession which funds it, the cost of which is ultimately passed onto consumers.

Principle two - We will ensure that the professional contributions to the fund are as manageable as possible for those we regulate.

In order to help firms and solicitors plan ahead, we will strive to avoid significant fluctuation and volatility in the contribution levels. This means that we must, as set out in principle one, ensure provision is sufficient to cover a level of unanticipated claims as well as anticipated future demand. We will do this by maintaining a reserve that at least covers future demand and takes account of any exceptional cases (such as high value multiple claims), while minimising year-on-year fluctuations. This will protect the firms (and the fund and therefore the public) from the inevitable uncertainties in predicting claims arising in any one year.

Principle three - We will collect the contributions to the fund in a way that is manageable for those we regulate.

We will continue as a matter of general practice to collect the contributions annually, alongside the practising certificate fees, to minimise the burden of administration on firms. In line with the role of the fund in supporting public confidence in regulated firms and the reputation of the profession, we will continue to levy contributions from across all the regulated community. We will aim through the measure set out above to avoid the need to make additional collections in-year.

Principle four - We will be transparent about the fund monies and their management.

In order to make it clear how fund contributions are used, we will publish the compensation fund financial statements annually. We will ensure that the profession has the opportunity to comment on future contribution levels by including the proposed level in our consultations on, for example, our business plan or practising fee setting. We will also provide accessible information for the public, including the vulnerable, about the compensation fund, how it operates and how to access the fund without using potentially costly professional support.