

# Discussion paper

5 February 2024

## *Protecting the public: our consumer protection review*

- The deadline for submissions is **1 July 2024**.
- If you have any feedback, get in touch [<https://www.sra.org.uk/contactus>] .

We have launched a review of our overall approach to protecting consumers when they place their trust in a regulated law firm – our consumer protection review.

### *Our aims*

Consumers – and what will deliver the best results for them – are at the heart of this review. Through this review we want to make sure that over the long term:

- consumers are appropriately protected when they use a regulated law firm
- public confidence and trust in legal services is maintained
- there is a competitive, dynamic legal market that supports access to justice through enabling consumer choice while keeping the costs of legal services down.

Reforms will need to be proportionate, targeted at identified risks, and consider the overall effect on consumers. This includes any impact on the supply and accessibility of legal services that might be caused by increased burdens and costs, either through the status quo or regulatory changes.

### *Our approach*

We will engage with the full range of stakeholders who will be interested in this review or impacted by it. We are committed to understanding different viewpoints and building the best possible evidence base.

We will move swiftly where we can make quick changes that will benefit the public. We are already implementing some changes and will continue to do so throughout the review where it is practical to do so. Other ideas will need to be considered in detail and need extensive engagement and consultation.

Below, we set out the reasons for the review, its scope, a timeline and how we will be engaging stakeholders.

This is a prompt for discussion and input, providing initial thoughts on areas we plan to look at and ideas we could develop. These are not proposals and some ideas will be more practical than others. We welcome your views on what actions you think we should take – both in the immediate and longer term – to deliver the best results in the public interest.

## *Why we are doing a review of consumer protection*

Over the last decade our approach to protecting consumers has generally worked well. People can trust that solicitors will be competent, having gone through a rigorous qualification process, and that new firms will have gone through appropriate checks. Most legal consumers are satisfied with the service they get.

Unfortunately, sometimes things go wrong. When they do, consumers have a range of protections. People can seek redress for poor service through an Ombudsman. They can make claims on insurance for negligence. If money goes missing, we run a compensation fund that can make good on losses. And if a solicitor has fallen short of the standards we expect, we will hold them to account and take action that protects the public going forward.

We are taking action now because the legal landscape is going through significant changes. Last October, we carried out our largest ever intervention – this is where we step in and close down a firm to protect clients. More than £60m of clients' money had gone missing from the law firm Axiom Ince due to suspected dishonesty. More generally we have seen a large increase in the number and size of interventions – last year we carried out more than twice as many interventions as the year before.

Given the shifting risks in the sector, it is the right time for a comprehensive review of our approach to protecting consumers when they use a regulated law firm.

We will look at what we can do to reduce the risk that consumers suffer harm in the first place. For instance, are there changes we can make to our monitoring processes so we can better spot market shifts and risks, so that we can reduce the risk of firm failures impacting consumers? Or should there be changes to our rules around firms holding client money?

It also raises questions about the sustainability of our compensation fund arrangements. This is a fund that can make good consumers losses when money has gone missing, for example, due to a solicitor's dishonesty or the collapse of a firm. How affordable will such protections be over the long term?

In considering changes to our approach, we will need to get the balance right. For instance, bolstering or even maintaining the current level of

consumer protection might not be in the public interest if it is unsustainable. It could lead to large increases in prices or reduced choice for consumers, negatively impacting access to justice. We therefore need to look at the overall impact on consumers. We are particularly conscious of the pressures faced by small firms, including those providing services to vulnerable consumers.

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### *Scope: what we will cover in the review*

There are two main areas we will be looking at:

1. Our policy and operational arrangements for identifying and managing or mitigating risks in the marketplace to clients and client funds.

We will be reviewing a broad span of our operational and policy processes including looking at:

1. how we identify sector risks
2. how we monitor firms
3. our approval processes for firms
4. our rules and controls around client money
5. our approach to firms' structures and ownership models.

2. Our compensation fund arrangements in light of the risks identified

We will be reviewing the compensation fund model in order to make sure that there is appropriate protection over the long term.

Below, we set out further details on the issues we want to discuss with stakeholders. Some of the ideas and areas for exploring change will be more realistic to implement than others. We have sought initially to put a wide range of suggestions on the table, so we can explore with stakeholders, refine our thinking, and identify the approach that will deliver the best results overall in the public interest.

We will be considering both incremental changes, as well as asking more fundamental questions about our approach. For example, in looking at how we protect client money, our review will include whether we should increase monitoring for higher risk firms. Yet we will also be asking the bigger

question of whether the whole model of law firms directly holding client money is the best approach.

Likewise with the compensation fund, we will be looking at the detail of how we operate the fund such as how we might use a cap or if there is a case for reducing the maximum pay out. We will also be asking fundamental questions like:

- Whether the compensation fund should continue to provide such wide-ranging cover for the public?
- Is the balance between insurance and the fund correct?
- Should we set levies for the profession based on a specific firm's risk?

There will likely be strong arguments for maintaining the current level of protections, but we need to be sure that is sustainable and proportionate in the face of evidence of escalating risks.

There are also different issues to address. How we tackle the risks around fraud and dishonesty may need different solutions to how we manage the risk of firms failing due to other issues or behaviours that could still put client money at risk.

### *Timeline – short, medium and long term*

We will be looking at what changes we could make over the short, medium and long term. We are already implementing some changes, while others will take longer as they need extensive engagement and consultation.

Below, set out a summary of the type of work – and changes we could be making – over the short, medium and long term. We have included an initial timeline [a heading\_6472] at the end.

### *Short term*

We are already act in light of the recent significant intervention into Axiom Ince, and general increase in interventions. This includes:

- an initial review of our internal processes in light of the recent significant intervention into Axiom Ince. For instance, although our visit to the firm ultimately identified the suspected fraud, which had not been spotted by other parties, we have increased our checks around bank statements to reduce the risk of such activity not being identified.
- bolstering monitoring of areas where there may be increased risks. We are progressing a programme of inspections of accumulator firms to assure ourselves that any risks to the public are being appropriately managed. We will also be visiting other firms who have grown rapidly. We will share with the profession evidence of good and poor practice.

- building risk factors identified through the Axiom Ince case – and other visits to accumulator and growing firms – into our prioritisation criteria for targeting future monitoring and oversight activity.
- liaising with the Legal Services Board as they carry out their independent review of the events leading up to the intervention into Axiom Ince taking account of findings and any additional lessons learned.

Beyond implementing immediate operational changes, our focus at this stage will be on:

- gathering evidence from stakeholders
- considering insights from our inspections and thematic reviews
- analysing data to identify learnings and trends that could inform medium and longer term changes.

### *Medium term*

In the medium term, there are other areas we will be working through where we could make changes. We are already looking at measures, such as:

- improving our risk assessment processes based on our emerging findings and intelligence from our proactive work, as set out above
- developing guidance for firms with practical steps that can be taken to address risks
- engaging with reporting accountants to identify any improvements that can be made to their inspection processes
- further checks and controls either during or following an acquisition, including around the taking on of client money.

As we progress our work and engagement with stakeholders in the coming months, we will look to identify other changes that could be implemented. This could include changes to our operational processes, monitoring of risk across the sector or targeted at individual firms, or guidance and communication with firms. For instance, we could consider whether we carry out inspections to check client balances for firms we assess as higher risk.

### *Long term*

There will also be more far-reaching, fundamental changes that could improve our approach, but will take longer to implement. This includes reforms that need changes to our rules. Such changes will need extensive engagement followed by robust impact assessment, formal consultation,

approval by the Legal Services Board, and a period of transition and implementation.

Examples of the types of changes that would require rules changes include:

- fundamental changes to our Accounts Rules and the circumstances when firms could hold client money, if at all
- changes to our rules around the criteria for approving firms and role holders such as compliance officers
- introducing new ongoing controls in terms of firms' structures or reporting
- changes to how we run our compensation fund, including how we set levies or assess claims.

### *Next steps and getting involved*

We want to gain as much input and insight from stakeholders as possible on how we could:

- improve our approach to consumer protection
- make sure it is fit to face the challenges of a changing legal landscape
- make sure it will deliver the best results to consumers.

Between now and the summer we will be running an extensive programme of engagement to understand your views. We will be meeting with a range of solicitors and their representative groups.

We will also be doing extensive engagement with consumers and their representatives. The range of engagement we carry out with consumers will include:

- deep discussion of the issues so we can test and understand their priorities
- their views on potential trade-offs
- the outcomes they want to achieve.

We will also be doing work to look at the approach across other regulators, sectors and in other jurisdictions.

There will also be other opportunities to get involved, here is an initial schedule of those opportunities:

- **12 March 2024** - Roundtable: representatives from high street solicitors focusing on issues concerning probate and conveyancing.
- **13 March 2024** - Roundtable: representatives from consumer groups.

- **21 March 2024** - Roundtable: solicitor representative groups.
- **26 March 2024** - Roundtable: representatives from local law societies.

You can also watch our on demand webinar

[<https://www.sra.org.uk/sra/news/events/on-demand-events/consumer-protection-review/>] to hear about the review in more detail.

We also welcome initial views on the scope of this review, issues we should be considering, evidence that could help inform our approach, or immediate actions you think we should be taking.

If you have any feedback – or if you would like to join us for any of the roundtables listed above – please get in touch [<https://www.sra.org.uk/contactus/>].

### *Consumer protection – areas to explore*

Below, we set out initial ideas and questions we would like to explore across the two main areas of the review:

1. Policy and operational approaches to identifying and managing risks.
2. Our compensation fund arrangements in light of the risks identified.

These are not proposals – instead they are prompts to help inform our discussion with stakeholders to help us develop our thinking.

We want to explore a broad range of issues and questions, even those that may be less realistic to implement at this stage or where there will potentially be significant arguments against. This is because we want to get as rich feedback as possible from stakeholders on potential options. This should help us refine our thinking and identify the best approaches to protecting consumers.

### *Policy and operational approaches to identifying and managing risks*

Key questions:

- What changes to our policies and operational processes would deliver the best results to consumers? For instance, could we change our approval processes for firms? Or how we monitor and track risks?
- What actions should we take to reduce the risk of law firms failing in a manner that results in significant consumer detriment?
- How can we further reduce the risk around firms holding client money? Should we consider changes around the rules as to when – or even



whether – firms can hold client money?

- How do we avoid introducing changes that result in unnecessary burdens on the sector that could reduce competition or push costs up for everyone?

### *Options to explore*

1. Enhancing our risk identification process:
  1. Bring together risks factors and red flags using data and learnings from recent interventions (and to the contrary good practice with similar transactions).
  2. Review the range of intelligence that we collect and hold to develop our risk identification strategy and undertake trend analysis.
  3. Reinforce our horizon scanning activity identifying market developments and how this feeds into operational processes.
2. Strengthening checks and controls as part of authorisation approval process:
  1. Expand checks into business plans, funding plans and governance structures.
  2. Additional checks with other organisations, for instance HM Revenue and Customs, for high risk firms.
3. Bolstering monitoring and supervision:
  1. Consider proportionate, targeted activity we could carry out to identify and monitor high risk firms.
  2. New activity could include proactively calling in information from firms, more direct engagement, and more targeted inspections of higher risk firms, including forensic checks of client accounts.
4. Restricting firms from holding client money:
  1. We will explore with other regulators, escrow account providers and insurers different approaches to managing the risks of holding client money. This could include alternative approaches to holding client money, or certain categories of client money.
  2. We would need to consider whether there are certain circumstances when it is or isn't prudent for firms to hold client money.
5. New targeted controls around client accounts and client money:





1. There may be certain risks flags that mean we should have tighter restrictions and more controls on certain firms – or business models – holding client money. For instance, linked to the type of work a firm does or its client profile.
  2. We could review the ways in which money is taken up-front, in advance of work being done, or our rules around managing residual balances.
  3. All firms must get an annual report from an accountant. We could review our requirements around this and how they work in practice.
6. Structural firm controls:
1. Should we tighten our rules to mitigate the risk that a small number of people can control management decisions, particularly in relation to accounts, such as our rules around the need for a firm to have a designated compliance officer.
  2. This could include exploring a restriction on the managing partner also being a compliance officer to reduce the risk around potential conflicts.
7. Assessing ownership models and corporate structures:
1. We could look at the sustainability of ownership models and corporate structures in the legal sector, and whether some carry more inherent risk.
  2. We could consider mandating greater transparency around ownership models and structures

### *Compensation fund*

The compensation fund is made up of annual contributions by everyone we regulate. It is there to protect consumers and help maintain trust and confidence in the profession.

Payments from the fund can be made to consumers, small businesses, charities and trustees where:

- money has been stolen or not been accounted for by someone we regulate, or
- a regulated person did not have insurance in place.

The current maximum we can pay for a single claim is £2m.

Key questions:



- Where does the balance lie between consumers being protected and making sure our approach does not push the cost of legal services up by too much and reduces access to legal services?
- Are there more effective and efficient ways to provide appropriate protection to consumers?
- Is it important that the fund offers cover to all consumers – and covers significant losses regardless of hardship – or is there a case for being more targeted in terms of who the compensation fund protects?
- Should we prioritise changes to other parts of our consumer protection approach – such as our approval and monitoring processes – to help manage risk to consumers rather than making changes to the compensation fund?
- How does and should the fund interact with the well-established, comprehensive insurance cover provided in the market and that all firms we regulate must have?

### *Options to explore*

1. Further limit who can make claims on the fund or what transactions are covered:
  1. The fund currently covers individuals, small businesses and charities.
  2. There could be greater targeting of the fund towards cases of financial hardship (eg some regulators only consider cases where clients will suffer financial difficulties as a result of the loss).
  3. Some schemes limit what types of transactions are covered – for instance, not typically considering claims linked to investments.
2. Recalibrate the capping provision:
  1. Our rules enable us to impose a discretionary £5m cap – no more or less – on claims to protect the solvency of the fund. We did not use this cap in the Axiom Ince case, as the scale of consumer loss if it were applied would be too large and lead to an unacceptable loss in public confidence in solicitors.
  2. We could change the rules around a cap to give ourselves more flexibility. And we could introduce aggregate limits for claims per person, per firm, per incident or connected incidents.
  3. Some regulators set a maximum total their funds will pay out each year.



3. Reducing the maximum payout for a single claim:
  1. Change the level of maximum payout – currently £2m.
  2. It should be noted that average payouts from fund are less than £40k.
4. Risked-based contributions for firms
  1. Firms currently pay a set amount and a contribution for every solicitor they employ. All firms benefit from the fund helping maintain trust in the profession.
  2. We could change this so firms pay a risk-based levy (eg this could be based on client balances or the risk profile of the work they do).
  3. Some firms would pay proportionately more, other firms may pay less if they are lower risk and/or have certain controls in place.
5. Tightening our rules so that no pay-outs are made until all avenues have been exhausted:
  1. Some regulators require claimants to pursue litigation or insurance claims before considering a claim.
  2. We could consider tighter criteria for urgent and emergency payments.
6. Phase out the compensation fund and limit the safety net to insurance:
  1. We could explore whether consumer redress could be provided by insurance arrangements without a compensation fund.
  2. Firms can choose to insure against fraud/dishonesty by their staff or other directors, but that insurance can only cover those who were not involved in the fraud (ie you cannot insure against your own dishonesty).
  3. Some regulators have put in place their own insurance-based compensation arrangements instead of running a fund.

### *Infographic - Timeline of actions and potential actions*

### *Timeline text version*

#### *Immediate actions*

- **Pre Jan 2024: immediate actions**



- Completed initial review of our internal processes in light of the recent significant intervention into Axiom Ince.
- Increasing inspections for firms where we think there may be higher risks (eg accumulator firms)
- Building risk factors learnt from Axiom Ince and other cases into our targeted monitoring processes
- **Jan - June 2024 - Evidence gathering and implementing short-term controls**
  - Engagement period with public, profession and other stakeholders exploring options
  - Develop policy/progress work, implementing more immediate changes we could make to improve our approach to consumer protection
  - Take account of findings from Legal Services Board's (LSB) independent review of the events leading up to the Axiom Ince intervention
  - Carry out thematic review looking at accumulator firms and acquisitions more generally

### *Medium term*

- **July - September 2024 - Policy development**
  - Policy development of medium to longer-term reforms following engagement
  - Progress changes that can practically be implemented in 2024
- **Up to December 2024 - implementing medium term changes following engagement**
  - Improving our risk assessment processes based on our emerging findings and intelligence from our proactive work, as set out above
  - Developing guidance for firms with practical steps that can be taken to address risks
  - Engaging with reporting accountants to identify any short-term improvements that can be made to their inspection processes
  - Further checks and controls either during or following an acquisition

### *Long term*

- **September - December 2024**
  - Public consultation
- **January - April 2025 - Deciding on longer term change options**
  - Post consultation analysis

- Post consultation decision
- **April - July 2025 - Approval process**
  - Submission to LSB of any proposed rule changes or changes to regulatory approach
- **By end of 2025 - Implementing longer term changes**
  - Implementation of any proposed changes