SRA BOARD
29 April 2025

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PART B: Apportionment of Compensation Fund contributions – post consultation position

What we consulted on

1 As part of our consultation 'Client money in legal services – safeguarding consumers and providing redress: Delivering and paying for a sustainable compensation fund', we invited views on a proposal to reapportion Compensation Fund (the Fund) contributions, moving to a position where 70% of contributions would come from individual solicitors and 30% from firms.

Why we proposed this

2 Since the 50/50 (individual solicitors / firms) split was set in 2010, the number of individual solicitors has increased significantly while the number of firms has decreased. This means there are fewer firms paying for their 50% 'share' of contributions now than in 2010, increasing the burden on those that remain. Using a 70/30 (individual/firm) split for setting contributions adjusts for the changing composition of the sector. This split would mean that the percentage increase in contributions from firms and individuals since 2010 would be similar.

3 In our impact assessment on last year's Compensation Fund contributions, we identified that the significant increases to the contributions 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, as 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. We said that a move to a 70:30 split could improve the positions for some smaller firms under a flat fee model where the same fee is paid for any firm holding client money.

4 Alongside questions on the apportionment of contributions to the Fund, we also asked for views on more fundamental changes to the way we set contributions that we might consider for the longer term. We set out four alternative models:

- Enhanced requirements: keeping 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, e.g. 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.

- Risk categorisation: 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.

- Annual turnover: 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.

- Amount of client money held by firms: the more client money held by a firm, the higher the Fund contribution. This 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.

5 Through consultation, we invited views on the different options set out above and any potential impacts that they might have.

6 We said in the consultation that changing the apportionment of Compensation Fund contributions from 50:50 to 70:30 is a change that we can operationalise quickly and would look to implement in 2025/26, should we choose to proceed with the proposal following consultation. More fundamental changes around variable contributions would take longer to develop detailed solutions for and to implement.

Recommendation

7 After analysing consultation responses, we have considered the proposal and are recommending that Board make the decision to keep the apportionment at 50/50 for 2025/26.

Feedback and insight from our consultation

8 We received 84 written responses to Part 3 of our Client money consultation on delivering and paying for a sustainable Compensation Fund. This included 19 individuals, 15 law societies, and eight representative bodies. We heard from 20 large firms (1000-101 ranked by turnover), seven very large firms (top 100 turnover), only two small firms (with four or fewer partners and with a turnover of less than £400k) and eight medium firms (firms of all other sizes). We also engaged directly and heard from stakeholders through a range of activities, including meeting with members of the profession and consumer representative groups, holding consultation events, polling members of the public and legal services professionals through our social media channels.

9 Consultation responses and stakeholder engagement showed limited support for a move to 70/30 apportionment with only 15% of respondents who provided written responses to the consultation supporting the proposals. The reasons for not supporting the proposals were varied, with some coming from different angles. They included:

- the rationale and benefits for the profession as a whole were not clear

- further analysis was required to support any changes including around claims on the Fund by firm type or practice area and the impacts of any changes on smaller firms and the consumers they serve
- while there would be benefit to some smaller firms this would be negligible
- there would be an unfair impact on larger firms who pay the individual contributions for the solicitors that they employ; and these firms are less likely to lead to claims on the compensation fund and/ or additional costs may result in a reduction in their ability to deliver benefits such as staff training and development etc
- the weight of contributions should be on firms that are better able to afford increases and / or there would be an unfair negative impact on individuals who pay their own contributions and particularly cohorts of individuals who are least able to pay an increase in contributions
- there were concerns that there may also be adverse impacts for clients of the largest firms if increased costs are passed on.

10 Furthermore, some respondents considered that we should not move from a 50/50 apportionment for contributions separately and ahead of considering the broader questions around differential contributions that we explored in the consultation. There were suggestions that we look at the potential advantages, disadvantages and impacts of differential contribution models, especially in terms of fairness and sustainability of the Fund first before making changes to the apportionment of contributions to the Fund. Some respondents felt that some of the suggestions for differentiating contributions would be fairer, for example, based on potential risk to the Fund.

11 A minority of respondents did support our proposal, agreeing that it was appropriate given the increase in the number of solicitors and the decrease in the number of firms over time. Some also highlighted the impact of the increase in Compensation Fund contributions for 2024/25 on smaller firms.

12 The Sole Practitioners Group’s view was that our proposal was an improvement on the current arrangements, but its preference would be to move to differential contributions for firms separated into three categories – individuals, small firms and large firms – and based on a combination of the amount of client money held by firms and annual turnover.

Our recommendation

13 As set out above, we are recommending that we keep the apportionment of Compensation Fund contributions at 50% from individual solicitors and 50% from firms that hold client money for 2025/26. Our proposal to change the apportionment of contributions to 70% (individuals) and 30% (firms) received only limited support from respondents to our consultation, with concerns raised over the rationale, overall impacts and proposed sequencing of the change. We have also observed that there would be positive and negative impacts on different groups, without a clear rational for changing the apportionment ahead of considering broader changes to how contributions are set i.e. potentially moving away from a flat fee model. .

14 We think there is further work to be done to consider both the concerns raised through the consultation and how changing the way we set Compensation Fund contributions

aligns with the longer-term actions we may take following the wider Client money consultation. Therefore, we are recommending to maintain the Compensation Fund contribution apportionment at 50 (individuals) and 50 (firms) for this year. As we are continuing to explore options for the future, we think it prudent to avoid making changes to contribution arrangements at this time, especially when we have not been able to identify appropriate changes for this year that would mitigate any disproportionate impacts on protected groups.

15 We are proposing to reduce the required contribution levels for all firms and all individuals for 2025/26. The proposed Compensation Fund contribution for 2025-26 is:

- £70 for individuals – which would be a reduction of £20 from the £90 that individuals paid in 2024-25
- £1,950 from law firms that hold client money - which would be a reduction of £270 from the £2,220 that law firms holding client money paid in 2024-25.

16 Under a 70/30 split individuals' contributions would likely rise to £100 and firm contributions would decrease to £1,170.

17 Although we have identified some potential benefits for smaller firms who feel the greatest impact from the flat fee share of firm contributions, by changing the apportionment of contributions to 70% (individuals) / 30% (firms), we also identified potential adverse impacts on large firms and solicitors who pay their own Compensation Fund contributions.

18 Under a flat fee approach, small firms and those working in less profitable areas of practice can be impacted more by increases to the level of firm contributions. Our data indicates that in smaller firms, and firms doing mainly criminal law, there is an overrepresentation of certain groups. This includes older solicitors, disabled solicitors, men, Black, Asian and minority ethnic solicitors, those from Hindu, Jewish, Muslim and Sikh faith groups, and people from lower or intermediate socio-economic backgrounds. It is not clear that a change in apportionment would significantly address disproportionate impacts on these groups.

19 We know that many firms pay the Compensation Fund contributions on behalf of the solicitors they employ, so a change in the individual solicitor contribution rate has the potential to dampen any positive impacts from a reduction in the firm based contribution from a 70:30 split and to have negative impacts on firms that employ a significant number of solicitors.

20 Furthermore, about a quarter of solicitors pay their own contributions. Moving to a 70/30 apportionment would have adverse impacts for this group of solicitors. Respondents to our consultation specifically mentioned the potential impact on in-house solicitors. Solicitors working in-house may be less likely to have their contributions paid by their employer. We know that women are overrepresented in the in-house solicitor community. Similarly, solicitors who may have lower incomes and not have their contribution paid by an employer, for example, those working part-time or intermittently during the year, such as those on maternity leave may also be exposed to an additional impact when compared to other solicitors.

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21 As the contribution amount for both individuals and firms has reduced this year, there is less urgency to make a quick change to apportionment arrangements. We now have an opportunity to explore more fundamental changes to the way we set Compensation Fund contributions. Maintaining the current apportionment of contributions at 50% (individuals) and 50% (firms) will allow us to consider both the concerns raised through the consultation and how changing the way we set Compensation Fund contributions aligns with other longer-term actions we may take following the wider Client money consultation.

22 We think it prudent to avoid making changes to contribution arrangements at this time, as we continue to consider long term alternatives to a flat fee approach in determining the level of contribution firms should make, including possibly setting differential contributions for example, based on turnover or amount of client money held by firms. There's a risk that we could introduce a temporary change which could conflict with the direction of travel we take on contributions to the Fund in due course.

Next steps

23 We will publish the decision on apportionment and summary of responses to the relevant consultation questions alongside the draft Business Plan and Budget consultation documents in May 2025.

24 Later in 2025 we will bring to Board a full analysis of responses to all the consultation questions on the Compensation Fund and proposed direction of travel.