

Protecting users of legal services - prioritising payments from the Compensation Fund: Consultation

Supporting evidence and analysis

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Introduction

Overview

1. This report sets out evidence and analysis to support a revised and updated package of measures to reform how we operate the Compensation Fund. These proposals are explained in our [consultation paper](#) and should be read in conjunction with each other.

Key findings

2. Our key findings are:
 - Most payments from the Fund are relatively low. Over the period 2010 to 2018, more than 75 per cent of claims paid were for less than £5,000.
 - Higher value claims tend to arise from a limited range of legal services, generally to stolen probate, mortgage monies and damages settlements.
 - Historically, average payments have remained relatively stable over time, except for payments relating to the loss of probate monies which show an upward trend.
 - The risks in the market and consumer behaviours when using legal services are changing and this could give rise to higher losses and a different pattern of applications and payments in the future.
 - This is increasing the potential liability of the Fund and we are building a £30m contingency reserve for anticipated payments. This has resulted in considerable spikes in the levels of contributions from the profession.
 - In terms of eligibility, prioritisation criteria and scheme limits, the SRA Compensation Fund is generous compared to funds operated by other legal services regulators.

Trends in payments and contribution levels

Pattern and nature of claims/payments

3. Table 1 below shows the number and average value of claims paid over the period 2014-2019¹.
4. Claims mainly arise when we have intervened in a firm, although there are cases where we receive applications, but we have not intervened. Consistently the reasons that give rise to highest amounts in total from the Fund are the financial losses suffered by clients or beneficiaries because of a conveyancing (£45.4m) or probate transaction (£22.5m).
5. Overall, the average for all payments have remained relatively stable over the period at around £20,000. For probate matters the average payment has increased from £37,000 in 2014 to £85,000 in 2018.

Table 1

		%	Total value (£m)	%	Value (£)
Conveyancing	1182	26%	£45.4	48%	£38,377
Probate	457	10%	£22.5	24%	£49,185
Return of money paid for costs	2079	45%	£6.6	7%	£3,178
Counsel and experts' fees	89	2%	£2.1	2%	£23,780
Damages	612	13%	£2.2	2%	£3,555
Other²	178	4%	£16.5	17%	£92,430
Total	4597	100%	£95.2	100%	£20,707

¹ Includes payments up to June 2019

² Other includes claims reasons such as fraud and gross overcharging which tend to be infrequent but relatively high value payments

Distribution of payments

6. Table 2 below shows the distribution of payments over 2010-2018.³

Table 2

Band	Number		Value	
	Nb	%	£m	%
No Payment	8,725	-	£0	-
< 5,000	5,673	74.5%	£6.2	4.4%
5,000 to 10,000	478	6.3%	£3.6	2.6%
10,000 to 25,000	573	7.5%	£8.8	6.3%
25,000 to 50,000	320	4.2%	£11.6	8.3%
50,000 to 100,000	235	3.1%	£16.7	11.9%
100,000 to 250,000	231	3.0%	£37.1	26.5%
250,000 to 500,000	77	1.0%	£26.2	18.7%
500,000 to 1,000,000	25	0.3%	£16.9	12.0%
1,000,000 to 2,000,000	6	0.1%	£9.2	6.5%
> 2,000,000	1	0.0%	£3.9	2.8%
Total payments/open claims	7,619	100%	£140	100%

³ The table shows claims where: we have closed a claim with no payment; we have made a payment or we still have an open claim (so are reserving a level of payment).

Total including zero payments	16,344	-	-	-
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7. The table show the number, value and percentage of payments for payment banding ranges. It also shows that we closed more than 50% of the claims we received in this period without making a payment.
8. Most payments from the Fund are relatively low - over the period 2010 to 2018 more than 75% of payments made were for less than £5,000.
9. Frequent but lower value payments include where a solicitor has misappropriated money that a client has paid to them on account of costs for example for example advance payments to cover barristers' or experts' costs. For example, Table 1 shows there were more than 2,000 average payments of around £3,000 for the period covered in that table to alleviate a client's financial loss of money held on account costs. Other reasons for low payments include loss of lower value damages settlements and for conveyancing where a solicitor has failed to pay Stamp Duty Land Tax.
10. There were 32 payments (0.4%) above the proposed lower single claims limit of £500,000 (or in total £14m which is 10% of the amount paid out).
11. These highest single payments almost all involve stolen probate and mortgage monies or damages settlements.

Future risks that could result in applications to the Fund

12. The risks that give rise to applications to the Fund are changing. For example, there is a wide spectrum of solicitors' involvement in investment cases which could give rise to claims including:
 - a. crude and obvious high-yield investment fraud
 - b. obscure or esoteric investments that are very likely to be frauds – such as “rare earth minerals”, “carbon-credit trading” and so on
 - c. new approaches such as selling (by conveyancing) individual hotel rooms, car parking spaces, storage units, care home rooms and student flats
 - d. The sale of unbuilt properties abroad either as investments or holiday homes or both – which are not built

e. The sale of such properties in the UK – which are also not built.

13. We have issued a number of warnings in the past about solicitors involved in [dubious investment schemes](#). We continue to refuse many claims on the basis that the involvement of the solicitor was not part of their usual business, and/or on the basis of the contributory conduct of the claimant in failing to carry out due diligence.
14. However, the nature of these schemes (and the way law firms operate in respect of them) is continually changing meaning for some schemes the situation may be different. We are already paying out for a failed scheme involving the sale of 'off plan' holiday homes abroad where we expect payments to be well in excess of the £5m limit we are proposing where we receive multiple applications arising from a single or connected event.
15. There are other failed schemes we are aware of involving losses of tens or even hundreds of millions of pounds we are aware of that could give rise to potential applications. We keep these schemes under close review and assess the likelihood that we make payments relating to these schemes. This is increasing the potential liability of the Fund and we are building a £30m reserve for anticipated payments. This has resulted in considerable spikes in the levels of contributions from the profession.
16. In relation to investment and similar schemes there are often other compensation schemes available for the same or a similar loss that have lower limits than the SRA. For example, the Financial Services Compensation Scheme (FCSC) which has a maximum pay out of £85,000 per person per firm for losses arising from investments covered by their scheme.

Trends in contribution levels

17. Details of contribution levels since 2010/11 and related estimated payments are set out in Table 3.
18. This includes the impact to date our approach to accumulate a £30m reserve for high values losses arising from contentious cases over the three-year period (2018-19 to 2020-21).⁴

⁴ We will review this approach based on latest assessment of potential liabilities when we set the contribution level for 2020-21.

19. Because we are building up this contingency, total contributions from the profession are double what they would have otherwise been⁵ The trend in contributions is shown below.

Table 3

Year	Firm Fee (£)	Individual Fee (£)	Total Value (£m)
2010/11	£10	£120	£2.1m
2011/12	£60	£772	£13.5m
2012/13	£92	£1,340	£21.9m
2013/14	£56	£852	£13.4m
2014/15	£32	£548	£10.0m
2015/16	£32	£548	£8.4m
2016/17	£32	£548	£8.5m
2017/18	£40	£778	£11.1m
2018/19	£90	£1,680	£25.6m
2019/20	£60	£1,150	£17.5m

⁵ Using the average fee over the period 2010-2018

Comparative analysis

Eligibility and prioritisation criteria

20. Table 4 compares our own scheme eligibility and prioritisation criteria against other schemes. Table 5 provides more detail about our current eligibility criteria.

21. The legal services regulators' and the Royal Institution of Chartered Surveyors (RICS) scheme are discretionary schemes set up to allow applications where people have lost money because a regulated person or firm has dishonestly taken or wrongly used their money. The Legal Ombudsman's (LeO) rules relate to the payment of compensation by a legal services professional to an individual as a result of poor standard of service. The Financial Services Compensation Scheme (FSCS) protects consumers when a financial services provider has failed.

Table 4

Scheme	Eligibility thresholds	Other prioritisation criteria⁶
SRA	<p>Covers all individuals and charities and trusts</p> <p>Covers businesses with turnover of less than £2m⁷</p> <p>Hardship tests are applied to determine eligibility for some claimants and some types of losses</p>	<p>Applicant needs to have:</p> <p>taken appropriate steps to exhaust all other avenues of redress</p> <p>not contributed to their loss</p> <p>Work must form part of professional activities of a solicitor working in a regulated firm or as a freelancer</p>
Institute of Chartered Accountants in England and Wales (ICAEW)	<p>Covers individuals</p> <p>Covers small businesses and charities/trusts with turnover less than £1m</p>	<p>Applicants may need to exhaust other remedies before considering a grant.</p> <p>have grant reduced or rejected where contributed to loss</p>

⁶ We have included key criteria – there may be other criteria that are applied in each scheme that we have not included in the table

⁷ This is consistent with the turnover in the EU definition of micro-business

probate scheme		Work must be authorised probate services
Chartered Legal Executives (CILEx)	<p>Covers “consumers” – individuals acting for the purposes which are wholly or mainly outside of that individual’s trade, business, craft or profession.</p> <p>Covers trustee of a trusts with net asset value of less than £2m or any other “person” with annual income/turnover after tax of less than £2m.</p> <p>The scheme applies hardship tests but only when considering interim payments</p>	<p>Applicant has to be a client or former client of the authorised entity⁸</p> <p>Applicants may to exhaust other remedies before considering making a discretionary grant.</p> <p>Applicants claim may be reduced or refused if loss can be recovered in another way.</p> <p>where contributed to loss their own financial circumstances mean they will not suffer financial difficulties because of the loss</p> <p>Work must be authorised</p>
Council for Licensed Conveyancers (CLC)	There are no explicit threshold tests	<p>In determining claims the CLC takes into account whether the claimant has recovered or could recover their losses by others means</p> <p>could have taken steps to mitigate the loss</p> <p>the behaviour of the claimant</p> <p>Work for which the CLC regulated practice is responsible</p>
LeO	Covers individuals	The complainant must have received the benefit of the service – so this covers

⁸ 6 (5) For the purposes of rule 6(1), a person is eligible if that person is a client or former client of the Authorised Entity

	Covers micro enterprises ⁹ and charities and trusts with annual income net of tax or assets of less than £1m	beneficiaries of estates even if they did not directly instruct the lawyer.
FSCS	Covers individuals Some businesses, charities and trusts may be eligible depending on the claim. ¹⁰	The applicant must be a direct client of the failed firm ¹¹ , The firm regulated by the Financial Conduct Authority (FCA) must have failed and have no money The firm must owe the claimant a civil liability in connection with a regulated activity
RICS	Covers any member of the public which is a client of an RICS Registered Firm A member of the public includes any person, firm, trust, body corporate or other organisation.	The applicant must be a client of a RICS registered firm and the firm has the primary duty to make full restitution The applicant has exhausted other avenues of redress The loss of money jointly held by the client/firm where the client has contributed to the loss

Current Compensation Fund eligibility criteria

22. The current eligibility criteria and where we apply hardship criteria to assess eligibility are set out in the table below. They vary depending on who the

⁹ Enterprises that employ fewer than 10 persons and whose annual turnover or annual balance sheet total does not exceed €2m.

¹⁰ For example: the threshold for investment claims uses the Companies Act 2006 definition of a small firms (£10.2m); the threshold for insurance claims is set much lower at £1m; there is no threshold for long term insurance contract claims or deposits. Business owners and directors of charities and trusts can check eligibility through a pre-screening process.

¹¹ But in some cases the FCA will 'look through' company structures to treat some-one as the claimant

applicant is (ie a private individual, a business or a charity) and the cause of the loss (dishonesty, hardship caused by a failure to account for money, or an uninsured loss).

Table 5

Claimant Type	Loss due to the dishonesty of a regulated person	Failure to account for money causing hardship	Loss which should have been insured
Private Individual	Eligible	Eligible – will deem hardship	Eligible
Business with turnover more than £2m a year	Not eligible	Not eligible	Not eligible
Business with turnover less than £2m a year	Eligible	Eligible if able to show hardship	Eligible
Charity with annual income or trust with annual assets of more than £2m a year	Eligible if able to show hardship to its beneficiaries	Eligible if able to show hardship to its beneficiaries	Eligible
Charity with annual income or trust with annual assets less than £2m a year	Eligible	Eligible if able to show hardship to its beneficiaries	Eligible

Scheme limits

23. We have also reviewed other regulators' approaches to how they might cap or limit the liabilities of the compensation funds schemes that they are responsible for. In 2013 as part of an earlier consultation, we commissioned a [comparative study of other regulators](#), and have revisited and updated for this consultation.

The analysis is set out in Table 6 below. The schemes apply (in various combinations) limits:

- a. single limits per individual claim or loss
- b. aggregate limits per lawyer or law firm or single intervention
- c. total limits per year (a total amount that can be paid out in a single year).

24. All other schemes have lower limits compared to our Compensation Fund.

Table 6

Regulator	Description of Limits
Law Society of Ireland	To make sure the fund is protected, the Law Society of Ireland operates a loss insurance policy each year. The policy has an excess of €5m and cover of €50m in place to cover the excess.
The Finnish Bar	Takes the available assets of the compensation fund into account as one of the factors in deciding whether to make a grant.
The Danish Bar and Law Society	The Fund will pay up to the current minimum of mandatory insurance and no further – regardless of the actual damages which may have been suffered. ¹²
Washington State Bar Association	Makes gifts from the Fund. Approved gifts will be paid up to \$5,000 upon final approval, any remaining balance on the approved gift will not be disbursed until fiscal year end and may be subject to proration. The maximum gift that can be made by the WSBA is \$75,000.

¹² In 2016 minimum insurance was 2,500,000m DKK (approximately £3m sterling at as July 2019)

Bar of Maryland	In most cases the client can claim the full amount which was wrongfully taken. The amount reimbursed, however, cannot exceed 10 per cent of the value of the Fund as of the close of the prior fiscal year.
The State Bar of Arizona	The Trustees can pay up to \$100,000 on one individual claim, and up to \$250,000 total in claims against one lawyer.
The State Bar of California	A maximum of \$100,000 is reimbursable if the loss occurred on or after January 1, 2009.
The Florida Bar	<p>Applicants may recover the amount of misappropriated or embezzled funds up to a total of \$250,000. All claim payments are kept until the end of each fiscal year.</p> <p>If the funds exist to pay all approved claims in full, those payments are made.</p> <p>If there are not enough funds available to pay all approved claims in full, claims are made on a pro rata (partial) basis.</p>
The State Bar of Texas	<p>The maximum payment allowable under the rules is \$30,000.</p> <p>At the time of payment, the Committee may pay a percentage of each approved claim, depending on the resources of the Fund during the year of the payment.</p>
New York State Bar Association	<p>There is a \$300,000 maximum limit per law client loss on the Fund.</p> <p>There is no aggregate maximum loss on awards involving one lawyer.</p>
The Law Society of Ontario (formerly Upper Canada)	<p>Operate a 'per claimant' limit of:</p> <p>\$10,000 per client for paralegal dishonesty</p> <p>\$150,000 for lawyer dishonesty (from 2008 onwards)</p>

Northern Ireland Law Society`	<p>It is the Council's policy not to authorise a grant to any applicant which would result in an aggregate sum exceeding £750,000.</p> <p>The Council may also take into account the need to maintain sufficient funds in the Compensation Fund to meet the needs of other applicants.</p>
National Federation of Property Professionals	<p>The scheme will compensate a landlord or tenant up to £25,000. However, landlords are limited to a maximum of three months' rent.</p> <p>The total payable in respect of a member company would be £500,000.</p> <p>In any one year the scheme has a limit of £3m.</p>
Financial Services Compensation Scheme	<p>The FSCS can pay compensation only for financial loss.</p> <p>Compensation limits are per person per firm, and per claim category. The maximum levels of compensation are:</p> <p>Deposits - £85,000 per person per firm</p> <p>Investments - £85,000 per person per firm</p> <p>Home Finance - £50,000 per person per firm</p> <p>Insurance Business – unlimited. Protects 90 per cent of the claim with no upper limit.</p>
CLC	<p>No information on limits in the public domain.</p>
The Law Society of Scotland	<p>The maximum grant payable from the fund is £1.25m. It may be paid in instalments.</p>
RICS	<p>Each claim per member of the public is limited to a maximum of £50,000 per claim. RICS apply a cap on liability of the scheme as a whole in respect of any single financial year: this is currently set at £10.3m for any one calendar year.</p>
ICAEW/ Institute of Chartered	<p>The ICAEW, ICAS and Chartered Accountants Ireland operate a compensation scheme for members of the public</p>

Accountants of Scotland (ICAS) / Chartered Accountants Ireland	who have incurred a financial loss as a result of investment advice given by an authorised firm of chartered accounts. The scheme can pay a maximum of £50,000 per claim.
ICAEW – probate scheme	£500,000 per claim/per estate and £5m aggregate per year
CLIEEx scheme	£500,000 per claim and aggregate £2m per firm

Scheme limits: focus on other Legal Services Act approved regulators

25. Three legal service regulators in England and Wales have put in place a compensation scheme (CLC, CILEc and ICAEW). They all have or have consulted on having a single limit of £500,00. For ICAEW probate scheme the limit is applied per estate. CLC has consulted on an aggregation limit of £1m per intervention and CILEx have an aggregation limit of £2m per firm. The ICAEW scheme has an annual aggregation limit of £5m.
26. The regulators provide general explanations that their arrangements have been designed with regard to the likely nature of claims on the scheme to provide proportionate limits recognising the finite nature of the scheme. There is limited data in the public domain about the pattern of historic or expected claims.
27. CILEx for example say that ‘in the absence of data for their market’ they considered data available from other regulators as a means of assessing the impact of their limits. As well as a limit of £500,000 they apply a limit of £2m per firm suggesting that based on ‘anecdotal’ information that it would appear very unlikely that that aggregate limit would be breached.
28. Some other professional services schemes have much lower limits. For example, RICS scheme covering surveyors, and the ICAEW scheme for accountants have limits of £50,000 and the FSCS scheme covering saving deposits is £85k. These schemes are also designed on the likely pattern of claims. Law firms will hold higher amounts of client money than the relevant professional service providers. This is due to the nature of the services which they hold client money in relation to. For example, the average house price is currently £235,000 (a loss covered by our scheme) compared to average tenants’ deposits of around £1,000 (covered by RICS) and average saving deposits of £26,000 (covered by FCSC).