

## **Exercising the statutory power to pay the cost of firm interventions from the Compensation Fund - analysis of responses and SRA response**

### **Introduction**

1. This report follows the SRA's recent consultation on the proposal that the Compensation Fund is applied by the SRA to make payment for any costs, charges or expenses incurred following a decision to intervene into a solicitor's practice/recognised body and includes the SRA's responses to the issues raised by respondents.
2. The consultation explained the SRA's proposals to meet the costs of interventions from the Compensation Fund. The continued, difficult economic environment had increased the number of interventions carried out by the SRA and had given rise to additional and exceptional intervention costs. There is a clear risk this trend will continue in 2014 and onwards. As the cost of interventions is ultimately met by the regulated community, it was important to raise this issue and for the SRA to seek views on the proposal.
3. The consultation:
  - sought views on our proposal; and
  - if the proposal was not agreed, views were sought on alternative methods of funding interventions.

### **Responses received**

4. 24 responses were received from stakeholders, including individual solicitors and firms of varying sizes, the Council of Mortgage Lenders, the Law Society and local law societies. A list of respondents is attached at the end of the paper.

5. There were four respondents who fully agreed with the proposal. Respondents also considered it was prudent that the SRA was able to investigate firms and deploy regulatory tools without budgetary constraints. In addition, it was felt firms could not afford huge increases in practising fees to cover the failures of those in the profession who had failed to properly manage their business.
6. Other respondents did not agree with the proposal, however, were unable to provide details of alternative methods of funding interventions which sat outside of the SRA budget or Compensation Fund and which would not have a financial impact on the profession. Many of the responses demonstrated that respondents misunderstood the regulatory environment, the powers given to the SRA under the Solicitors Act 1974 (as amended) and that that default by law firms requiring intervention and/or grants from the Compensation Fund were not predictable in the way that an operating budget could forecast .
7. Those who disagreed with the proposal did so for differing reasons. The reasons given included:
  - the mode of contributions to the fund was unfair when compared to the mode used for setting practising fees - the impact on smaller firms is therefore, likely to be greater and causing potential financial hardship;
  - the Compensation Fund was there to compensate clients who had suffered loss through the dishonesty of a solicitor; and,
  - the Compensation Fund should not be used to financially support the SRA in it's regulatory activities.
8. The Law Society and others recognised that to pay for unbudgeted costs of interventions in 2013 using the Compensation Fund was a preferred option to a levy on the profession. The Law Society however, stated that further detailed work was required having regard to the varying costs which the Compensation Fund would have to bear now and in the future.
9. The Law Society and other respondents discussed the need for the SRA to consider other alternatives to intervention and managing the associated costs.

**SRA response:**

10. Our primary objective when engaging with firms is to ensure that clients are protected and to avoid intervention unless absolutely necessary. There is an increased risk of misuse of client money by firms in financial difficulty.

11. Intervention will usually be the last resort in such cases but will often be necessary more urgently in other situations such as to avoid risk to the public arising from the activities of a practitioner suspected to be dishonest or continuing risk to clients arising from a client account shortage.
12. It must be remembered that the power to intervene is a regulatory tool available to us. In the circumstances, it is difficult for us to plan for such events as a decision to intervene will only be made where one of the grounds set out in legislation have been met and it is necessary to intervene in order to protect the public interest. Where possible, we will always look to the intervened firm and culpable individuals to recover the costs incurred.
13. The Compensation Fund can be applied for purposes set out in Section 36A of the Solicitors Act 1974 and includes provision for applying the fund to other activities which includes for example, the payment of "*...costs, charges or expenses...*" incurred following an Intervention into a solicitor's practice. The Compensation Fund has been and will continue to be applied to deal with claims made by those who have suffered loss due to the dishonesty of a practitioner or their failure to account.
14. Considering the potential high end intervention costs for 2013, or even the levels of certainty around the best view scenarios which have been referred to in the consultation, it is difficult to see how we could sensibly budget for such costs within a normal operational budget. We are, in addition, moving into a position where now and for some time in the future, intervention costs will be unusually unpredictable. Given this, our view is that the cost of interventions are properly accommodated within a fund of the type provided by the Compensation Fund. As set out in Section 36A(9) of Solicitors Act 1974, the purposes of maintaining a Compensation Fund are to have provision outside an annual budgeting to deal with significant unpredictable or one-off events and to ensure that monies are available to protect the public following an intervention and the payment of grants.
15. We consider it appropriate to move to a position where the full costs of interventions are paid from the Compensation Fund. For 2013, the only costs that would be borne by the Fund will be any in excess of the amounts already contained in the SRA budget. For 2014 and onwards we propose to move all costs from the SRA budget to the Compensation Fund and we will prepare the SRA's proposed budget and Compensation Fund requirements on that basis.
16. We have considered the impact the proposal will have on those we regulate and it is conclusive that the cost of interventions have to be met by the regulated community whatever the mechanism - either through practising fees or compensation fund contributions. The cost to the regulated community will be the same overall; but there will be differences as to how the cost will fall arising from the different ways in which the Compensation Fund contribution and practising fees are apportioned for individuals, recognised sole

practitioners, recognised bodies and licensed bodies. This also applies should we call on Law Society Group reserves as they will inevitably have to be replenished by the profession through practising fees.

17. We have committed to reviewing our compensation arrangements and this includes the operation of the Fund and is due to report at the end of 2014. As part of that review, we will be considering the longevity of the proposal and whether there are alternatives. Until then it is proposed that the policy position forming this discussion remains.

### **Policy considerations**

18. A number of responses provided comment on how interventions and the associated costs could be managed. The suggestions made included:
  - the imposition of a capital adequacy requirement on individuals, through a letter of credit or similar instrument, to pay out if intervened into.
  - in cases of financial instability, consider the need to intervene and possible alternatives where client monies and interests can still be protected for example, the appointment of a client account manager to ensure client funds are protected whilst the firm is wound down in an orderly manner.
  - when interventions arise - take adequate steps to ensure that the process is managed effectively and economically including greater scrutiny of work carried out by appointed agents and other third parties.
  - the SRA to act as a facilitator between the firm's administrator and the firm to ensure regulatory requirements are met and clients are fully informed.
  - the SRA entertain early engagement with firms who demonstrate poor behaviours in respect of managing their firm and client matters
  - greater scrutiny of the decision making process when considering the need to intervene.
19. We are grateful for the suggestions which have been made as these will feed into the policy development of financial stability programme. Where appropriate, we will consider engaging further with respondents who have made suitable suggestions.

## **List of respondents**

Law Society of England & Wales

Vincent Sykes & Highman LLP

Legal Risk LLP

Christopher Davidson Solicitors LLP

Jonas Roy Bloom Solicitors

Birmingham Law Society

Council of Mortgage Lenders

Tunbridge Wells, Tonbridge & District Law Society

The Sole Practitioners Group

The Junior Lawyers Division

Citadel Law Limited

Mr John Daniels

Mr John Hall

Mr Christopher Robinson

James Button & Co

Mr Edward Austin

8 anonymous responses