



Solicitors
Regulation
Authority

**Proposal: Exercising the statutory power to pay
the cost of firm interventions from the
Compensation Fund**

Consultation paper

May 2013

Introduction

This document explains the SRA's proposals to meet the costs of interventions from the Compensation Fund. The continued, difficult economic environment has increased the number of interventions carried out by the SRA and has also 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 is important to raise this issue and for the SRA to seek views on this proposal.

The Solicitors Act 1974 (as amended, "the SA 1974") provides that the cost of interventions may be paid from the Compensation Fund ("the Fund").

Prior to the Legal Services Act 2007 ("the LSA 2007") the cost of interventions based on suspected dishonesty could be paid from the Compensation Fund and indeed were so paid for many years. The LSA 2007 extended this power to cover the cost of all interventions, but a decision was made in 2010 to meet intervention costs from practising fees. This decision however, did not take into account the underlying statutory power which had been applied previously.

There is no doubt about the statutory power to pay the cost of interventions from the Compensation Fund. Nor is there any doubt that the cost of interventions have to be met by the regulated community whatever the mechanism - although the SRA seeks to recover those costs where it can. The two methods of raising funds for that purpose are through the Compensation Fund or annual fees the most familiar of which is the practising certificate fee. It needs to be borne in mind that if the costs are not paid from the Fund, they will have to be borne by annual fees. The cost to the regulated community as a whole of the two options is 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 calculated. It also appears that the Fund has sufficient assets to meet the costs whereas payment from annual fees would have a greater impact on those fees sought for 2013-14.

Intervention costs are currently accommodated within the SRA operational budget. Annual fees charged to individuals and firms are mandatory and must be paid in order for individuals and firms to maintain their authorisation to practise.

Contributions to the Compensation Fund are also mandatory. The contribution is currently split evenly between firms holding client money and regulated individuals on a flat fee basis.

The SRA's current view is that, in principle, the cost of interventions should be met from the Compensation Fund, as envisaged by the Solicitors Act 1974 (as amended). Whilst the costs of interventions have been funded out of the SRA's operational budget, higher levels of costs for 2013 and onwards reinforce the case for the Compensation Fund to be applied to cover intervention costs.

That view is not driven by current economic conditions which are causing the failure of law firms – but the economic environment has two impacts:

- a. It confirms the underlying policy issue that default by law firms requiring intervention and/or grants from the Compensation Fund is not predictable in

the way that an operating budget can be forecast; the Compensation Fund is in place and holds significant reserves because of the need to have funds available for sudden defaults;

- b. There is a need for urgency in reverting to what the SRA considers the correct policy position. The declining economic environment has resulted in a number of firms experiencing financial difficulties and the appetite to acquire or merge with existing practices appears to be decreasing.

These factors have increased the number of interventions carried out and given rise to additional and exceptional intervention costs. The costs of interventions cannot be met through the SRA's 2013 budget and should be covered in general by Compensation Fund reserves: nor would it be sensible in future years to budget for uncertainty (which can lead to over-budgeting).

Our proposal

The Solicitors Act 1974 (as amended) provides express statutory power for intervention costs to be paid from the Compensation Fund. In the circumstances, the SRA considers it appropriate for these statutory provisions to be applied and

- a) for the **costs** (above those already in the SRA's 2013 budget) resulting from interventions in 2013; and
- b) **all** intervention costs from 2014 onwards;

to be met from the Compensation Fund.

Practising fees collected for 2013 will continued to be applied to meet the budgeted costs of interventions.

The Compensation Fund stands at £66.7m (end of March 2013). We estimate that this will reduce to £44.9m by the end of October 2013 as existing claims are met. The Fund contains sufficient resource in 2013 to meet even the high end intervention costs estimate.

In preparing the level of Compensation Fund contributions that will be set later in 2013 to cover the cost of the Fund in 2014, account will be taken of the increased costs that would fall on the Fund as a result of this policy change. The level of contribution required will be presented to the SRA Board and the Legal Services Board for approval.

The Compensation Fund is therefore, sufficiently maintained and has provision outside a determined annual budgeting process to deal with significant events and to ensure that monies are available to protect the public by intervention and the payment of grants.

The overall financial position suggests that a call on Group reserves would be highly undesirable as this sum, for prudent business management, will have to be replaced through practising fees for 2013/14. We therefore, consider that meeting the costs of interventions through the Compensation Fund will offset these risks.

Impact on those we regulate

We have considered the impact the proposal will have on those we regulate and from all perspectives 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 calculated for individuals, recognised sole practitioners, recognised bodies and licensed bodies. For 2013, there will be no additional requirement on the profession to contribute to the Fund. Details of current contributions are set out in the SRA's Fee Policy 2012/2013 (see www.sra.org.uk/fees).

As we plan for 2014, details of contributions to the Compensation Fund and practising fees will be set out later this year. Account will be taken of the possible increase in costs that would fall on the Fund as a result of the proposed change. To assist in our planning, we have considered potential scenarios in order to inform our view of the level of intervention activity which may be required in the remainder of 2013, the implications of those scenarios on financial resources (taking into account the interventions which have occurred this year) and our current best view on the most likely cost-range of interventions for the year. Details of the scenarios considered are set out in **Appendix 1** of this consultation.

An indicative example using the best view scenario set out in **Appendix 1** is set for information.

Assuming that the costs of interventions are £7,012,428, it is estimated that the financial impact on the profession will be:

For individuals

Practising fees (40% of the regulatory funding requirement) = £2,804,974
Based on an estimate of 121,000 regulated individuals, it is estimated that an additional £23.00 will be added to practising fees to cover intervention costs

Compensation fund contribution (50 % of the Compensation Fund funding requirement) = £3,506,214

Based on an estimate of 121,000 regulated individuals, it is estimated that an additional contribution of £28.00 will be added to the practising fee to cover intervention costs

For firms

Practising fees (60% of the regulatory funding requirement) = £4,207,457
Compensation fund contribution (50 % of the Compensation Fund funding requirement) = £3,506,214

Actual figures cannot be calculated for the purposes of this example, as firm fees are calculated based on the firm's turnover, whilst the compensation fund contribution is a flat fee payable by firms contributing to the fund.

Before making such a change in the funding source for the cost of interventions we believe it is important to seek the views from those we regulate and other key stakeholders given the current position and that shifting the cost of interventions to the Fund will have an impact upon who meets the cost.

We seek your views on our proposal. The Board's view is that the Compensation Fund is the best alternative to cover intervention costs above those budgeted in 2013 and all intervention costs in future years.

If you do not agree with the proposal, we seek your views on alternative methods of funding interventions. Intervened practitioners are liable to pay the cost of intervention but often do not have assets.

We particularly welcome views from the practitioners and firms we regulate, consumers of legal services, other regulators and those who may have an interest in how the Compensation Fund is applied.

Intervention activity

The powers to intervene are contained in the Solicitors Act 1974 (as amended) and other legislation. The powers exist in order to protect the public, whether they are exercised on the grounds of suspected dishonesty, breaches of the SRA Accounts Rules or a breach of the Code of Conduct. The powers enable the SRA to step in, for example, to prevent escalation of default, including where some other regulatory breach is the basis of the exercise of the powers.

The SRA's primary objective when engaging with firms is to ensure that clients are protected and to avoid intervention unless absolutely necessary. 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.

It must be remembered that the power to intervene is a regulatory tool available to the SRA. In the circumstances, it is difficult for SRA 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.

Costs which follow an intervention include:

- Fees of external Intervention Service providers for effecting interventions
- Archiving costs related to interventions
- Cost of the internal SRA Interventions team

The Compensation Fund

Section 36A of the Solicitors Act 1974 (as amended) provides for a compensation fund to be maintained and the associated rules provide for the Society (the SRA) to require the profession to make a contribution for the up-keep of the fund. Practitioners and recognised bodies will make contributions to the fund of such amounts, at such times and in such circumstances, as may be prescribed in or determined with the rules.

Section 36A of the Solicitors Act 1974 (as amended) sets out that:

- “(8) A compensation fund may be applied by the Society for the purposes mentioned in subsection (9) (in addition to the making of grants in respect of compensation claims).
- (9) The purposes are:
- (a) payment of premiums on insurance policies effected under subsection (6);
 - (b) repayment of money borrowed by the Society for the purposes of the fund and payment of interest on any money so borrowed;
 - (c) payment of any other costs, charges or expenses incurred by the Society in establishing, maintaining, protecting administering or applying the fund;
 - (d) payment of any costs, charges or expenses incurred by the Society in exercising its powers under Part 2 of Schedule 1;
 - (e) payment of any costs or damages incurred by the Society, its employees or agents as a result of proceedings against it or them for any act or omission of its or theirs in good faith and in the exercise or purported exercise of such powers.”

The link between intervention and the Compensation Fund was emphasised by the High Court in *Sritharan v Law Society* [2005] EWCA Civ 476, (at a time when only the cost of suspected dishonesty interventions could be paid from the Compensation Fund):

“It is, to my mind, important not to lose sight of the link between the obligation to maintain the Compensation Fund (now imposed by section 36(1) of the 1974 Act) and the power to intervene on reasonable suspicion of dishonesty (now contained in paragraph 1(1)(a) of schedule 1 to that Act). It is the power to intervene on suspicion of dishonesty which enables the Society to exercise control over those solicitors whose conduct might give rise to claims against the Compensation Fund; claims which, ultimately, have to be met by the profession as a whole.”

The original power was to pay intervention costs that arose from dishonesty interventions only. Experience has shown that losses to the Compensation Fund do not arise only from cases of dishonesty: for example, a failure to keep proper accounting records can cause substantial loss to clients and increase the cost of intervention because of lack of records.

It was pointed out to government that the impact on the Compensation Fund from other interventions, notably accounts rule breaches, can be just as severe as dishonesty and so the provision was extended to cover all interventions. That is why an extension of the power to pay intervention costs from the Compensation Fund was sought and obtained by amendment to the Solicitors Act 1974 (as amended) by the Legal Services Act 2007 (LSA 2007).

The Compensation Fund may therefore, 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. Subsection (9)(c) is also relevant in that interventions protect the Compensation Fund (and the word "protecting" was also added by the LSA 2007). For many years, the Compensation Fund paid for regulatory functions (and services shared with the Law Society) which contributed to maintaining the Fund. It appeared that this had become insufficiently transparent and much of it was stopped in 2010. It is not clear that the difference between the broad wording of (9)(c) and the very clear words of (9)(d) was fully understood.

The provision which covers intervention costs ((9)(d) – the "powers under Part 2 of Schedule 1" are the intervention powers) – is an express power, separate from the provision in 9(c). The thinking behind the provision is that a key purpose of intervention is often to take action that will prevent (further) loss to clients and thus potential claims on the Compensation Fund.

The distinction between (9)(c) and (9)(d) is also relevant in the context of the overall proposal to pay not simply the cost of (usually) intervention agents and logistical support incurred in exercising powers of intervention but also the cost of the SRA in-house intervention team which is essentially covered by both (9)(c) and (d). This is explained in more detail later in this paper.

The changing economic environment

The SRA has identified an increasing number of firms in significant financial difficulties emanating from the economic downturn, reforms in civil litigation - particularly for those heavily involved in personal injury, lenders tightening up on borrowing arrangements and poor financial planning and management. The SRA is applying increased supervision resource to assess the scope of the problem and to supervise the highest risk/impact firms more closely. It is evident that the economic situation is not improving and firms which were formed on poor foundations are in difficulty and are not being saved by new growth. The long tail of a slow economy is contributing to a significant market correction which well-run firms seem to have planned for whilst others have not.

In the current environment, there is a increased risk of misuse of client money by firms in financial difficulty. Therefore, there remains the risk of significant default of a common nature such as theft of conveyancing and probate funds.

The SRA's financial stability programme has identified a significant number of firms, including firms in serious financial difficulty. Early in 2013 Cobbetts, Blakemores and Atteys failed, alongside an increasing number of smaller, lower impact, firms.

In the cases referred to above there are two significant factors apparent, these are:

- the financial failure of firms of some significant size; and
- the need to intervene into such firms to protect client interests because no other firm is prepared to acquire the failing firm.

It is the combination of these two new factors that is causing additional intervention costs. With the coming pressures of legal aid changes, the implementation of the referral fee ban in personal injury cases and increased competition in the market, it seems likely that there will be a period of significant market correction perhaps over the next two or three years. Other tools such as education and communication are important to ensure so far as possible that firms understand their position and take necessary action to protect the interests of their clients and ensure that they are complying with their regulatory obligations. In the past, failing firms were able to merge or were acquired. Low levels of profitability in some areas of work are making acquisition of firms unattractive and therefore, existing firms are unable to continue to trade in the legal market.

This interplay can be illustrated by the different outcomes for the three firms referred to above. The financial failure of Cobbetts did not result in intervention as clients were protected by the acquisition of the whole of the business by other firms. The estimated cost of intervention, had it been necessary, was £6m. In the case of Blakemores, intervention was necessary as there was no overall acquisition of the firm and at the point of intervention there were a significant number of live cases. Therefore, the intervention costs were driven both by the need to manage those live cases and by the need to deal with the archive of closed files. In the case of Atteys, again, intervention was necessary as there was no acquisition. However, by the time of intervention there were few live cases as the majority had been transferred to other firms. The intervention costs are driven by the need to secure and manage a disproportionately large number of closed files.

We have not previously experienced the interaction of these factors in firms of any significant size. However, given our knowledge of the financial position of a number of substantial firms and current market conditions we now expect to see more.

Effecting statutory provisions to finance the costs of interventions

The statutory justification for paying for interventions from the Compensation Fund has been set out above. The risks that have now crystallised in respect of high cost interventions have always been present and it has always been understood that there might be exceptional circumstances in which the SRA might need to call upon additional funding and review the application of the Compensation Fund. Indeed, a new power was provided by the LSA 2007 for there to be a mid-year (rather than simply annual) contribution to the Compensation Fund. Section 36A(2) of the SA 1974 now provides:

“Compensation rules may require solicitors, or solicitors of a description prescribed in the rules, to make contributions to compensation funds of such amounts, at such times and in such circumstances, as may be prescribed in or determined in accordance

with the rules.”

The SRA Compensation Fund Rules 2011 include, at rule 2.3:

“Every *solicitor, REL, RFL, recognised body and licensed body* shall make contributions to the Fund in such amounts, at such times and in such circumstances, as may be prescribed from time to time by the *SRA*. Any unpaid contributions may be recovered as a debt due to the *Society*.”

This also supports the overall principle that the Compensation Fund is the source for the funding of urgent or unpredictable costs (arising, by definition, from default).

If we look at the potential high end intervention costs for 2013, or even the levels of certainty around the best view, it is difficult to see how any organisation 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 from a sound financial management perspective, 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 process requiring reliance on forecasting 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.

The SRA considers 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.

To ensure transparency we will report on the purposes (Section 36A(9)) the fund has been applied and specifically the amount paid by the Compensation Fund for intervention costs. Annual accounts for the Compensation Fund are available and we are considering how these can be presented through the SRA website.

As previously stated, the Compensation Fund currently stands at £66.7m (end of March 2013) and it is estimated that this will reduce during 2013 to £44.9m by the end of October as existing claims are met. The Fund contains sufficient resource in 2013 to meet even the high end intervention costs estimate.

In preparing the level of Compensation Fund contribution that will be set for the 2013 collection (to cover the cost of the Fund in 2014) account will be taken of the increased costs that would fall on the Fund as a result of this change. In 2014 and beyond, we will continue to use the information collected through the financial stability work project to inform projections and the level of fees and contributions to be collected.

Future developments of compensation arrangements

The SRA is conducting a fundamental, root and branch review of compensation arrangements. This means that we must consider whether we need compensation arrangements at all, not only as a means of protecting the consumers of legal services, but also from the perspective of the broader public interest. What does society require of professional service providers? If compensation arrangements are required, should they be funded by the sector or by some other means (such as fidelity insurance bought by clients)?

Can compulsory professional indemnity insurance be expanded to cover some or all of the claims paid from the current Compensation Fund? More broadly, is the regulated community willing – and able – to pay for the defaults of others? These are very significant questions of regulatory policy: reducing consumer protection would be a major reversal of at least half a century of increasing safety and raises issues likely to be resolved in a political – in the wide sense - rather than legal context.

The review will be evidence-based and transparent and will inform our policy-making decisions to ensure that solicitors compensation arrangements are fit for purpose in the light of changes in the legal services market.

The findings of the review and policy recommendations will be put out to public consultation and will include consideration of the longevity of the proposal being discussed in this paper and whether there are sufficient alternatives.

The final policy recommendations of the review will be based on the outcome of the consultation and the evidence gathered.

Further details about the compensation arrangements review being conducted can be found at www.sra.org.uk/how-we-work/compensation-fund/compensation-fund-review.page

How to respond

We welcome views on our proposal and any other aspect of this consultation and you can respond in a variety of ways.

Online

You can submit your response using our consultation response form. Visit <https://forms.sra.org.uk/s3/consultation-compensation-fund-intervention-fund>

Email

Send your email to consultation@sra.org.uk

Please ensure that

- you use the title 'Exercising the statutory power to pay the cost of firm interventions from the Compensation Fund' in the subject field,
- you identify yourself and state on whose behalf you are responding (unless you are responding anonymously),
- you attach a completed **About You form** ,
- if you wish us to treat any part or aspect of your response as confidential, you state this clearly.

Post

If you wish to submit your response by post, please send your response and a completed **About You form** to

Solicitors Regulation Authority
c/o Ms Yvette Wigg
The Cube
199 Wharfside Street
Birmingham
B1 1RN

Deadline for this consultation - Please send your response by 31 May 2013.

A list of respondents and responses may be published by the SRA after the closing date. Please express clearly if you do not wish your name and/or response to be published. Though we may not publish all individual responses, it is SRA policy to comply with all Freedom of Information requests.

The Solicitors Regulation Authority (SRA) is the independent regulatory body of the Law Society of England and Wales. We protect the public by regulating law firms and individuals who provide legal services.

Appendix 1

Costs and Forecast for 2014 and onwards

The cost of interventions have, since 2011, been carried wholly from within the SRA budget. Within the overall SRA budget there are three “intervention” elements that have their own budget lines:

- the cost of the in-house team of intervention officers (SRA employees);
- the cost for the external services of intervention agents (solicitors firms on a panel) and for Capita which undertakes immediate management of client files on intervention (indexing, weeding, repatriation, etc); and
- the cost for the archiving, repatriation and ultimate destruction of closed client files taken into the SRA’s possession at the point of intervention.

The most significant “in-year” variable cost (driven by the number of interventions and the scale of each) is the second of these elements. The third element is also impacted by the number and scale of interventions but the costs associated with this have a longer term effect given the current approach to the length of time for which closed client files from intervened firms must be kept.

For comparison the cost of intervention agents since 2011 is set out below:

- 2011 – 62 interventions, total cost in year of £1,970,000
- 2012 – 37 interventions, total cost in year of £1,160,000
- 2013 – budget and assumptions underpinning it – 30 interventions, total cost in year of £1,285,000.

The 2013 SRA budget for the in-house interventions officers is £229,000 and for archive costs is £1,600,408.

Our best view of the likely difference against budget between the cost of interventions in 2013 (immediate intervention agent and file handling costs plus the cost of archiving) is £7,012,428. However, it must be emphasised that this can only be an estimate.

Factors such as the financial failure of large firms and the need to intervene to protect client interests make it difficult to predict future intervention costs for these types of firm. In order to provide a reliable forecast of intervention costs, it is necessary to predict:

- that a firm will fail financially;
- that there will be no acquirer of the business as a whole prepared to assume responsibility for open and closed cases; and
- the number of open and closed cases that will need to be dealt with at the point of intervention.

Forecasting these variables can be difficult in relation to individual firms and even harder when trying to establish the overall picture.

Through the financial stability programme we are developing a view on the population of firms (focusing primarily on the high and medium impact firms) in serious financial difficulty. This view is adding to the information we already have and will inform the allocation of SRA resources and will inform the planning of possible future intervention activity.

The information obtained through the Risk Centre, Supervision and that provided by firms will support the continued maintenance of a catalogue of firms at high risk of intervention in the near future. This information drives operational activity in the relevant functions of the SRA and provides a “near” view of likely intervention costs. The information held includes likely interventions for the more “traditional” reasons of dishonesty, client money handling breaches and abandonments.

Our modelling of future intervention cost scenarios has two main elements –

- Element A - the costs incurred to date (or predicted to be incurred during the remainder of 2013) as a result of the interventions that have already taken place (including the high cost interventions into Atteys and Blakemores);
- Element B - scenarios based on the number of interventions and the size of each that may take place during the remainder of 2013 (April - December).

We can have a high degree of confidence (although not total as an element of these costs remains predictive) in Element A and a reduced level of confidence in Element B given that ultimately we must make an informed judgment from within a range of possibilities. The uncertainty within Element B arises not only from the difficulty in predicting the number and size of “financial failure” interventions but also predicting interventions that may arise for other reasons - for example, from a major investigation into potential fraud or dishonesty that may result in the need to intervene into a group of firms.

Element A estimate

To date we have intervened into 12 firms, of which four were carried out in-house with the eight requiring an external agent to be appointed. Based on current information on the state of these firms and the progress made to date on them our estimate of the cost of these interventions is:

- intervention agents and immediate file handling, £1,078,006 (as against a total 2013 budget of £1,285,000); and
- file archiving costs of £424,437 against a budgeted figure of £1,600,408. However, it should be noted we currently estimate that we also have £1,108,040 of 2013 archiving costs still to be incurred (relating to 2013 interventions).

This is a single best view figure with a confidence level within a range of +20%. These figures could increase by up to 20% depending on the size and weight of boxes that still need to be archived.

Element B ranges and best view

To inform modelling Element B has been stratified by the potential size of intervention into three levels:

- Level 1 – “traditional” interventions (arising for any reason including financial instability) of historically average size and cost £74,649 each;
- Level 2 – medium size/impact financial instability interventions (benchmark Blakemores/Atteys) costed at £1m each; and
- Level 3 – large size/impact financial instability interventions (benchmark Cobbetts) costed at £4.3m each.

The modelling also assumes that all interventions will require an external agent to be appointed to support the SRA and ensure that decisions are in a client's best interests.

Using the data we have available and applying our experience and judgement we assess the “worst case scenario” position for these levels as:

- Level 1 – 54 interventions
- Level 2 – 6 interventions
- Level 3 – 1 intervention.

On this worst case scenario the cost impact would be (for Element B alone):

- intervention agents and immediate file handling, £8,905,996 (as against a total 2013 budget of £1,285,000); and
- an increase in 2013 file archiving costs from the budgeted figure of £1,600,408 to £6,356,495.

That is purely an assessment of impact. To reach our “best view” we have applied a probability factor to each level. For Level 1 (where our level of knowledge is best informed by historic trends and firms will face interventions for reasons other than financial instability) we have applied a 90% probability. For Level 2 (informed by the experience of Blakemores and Atteys, i.e. some firms of this nature will fail and not be attractive to acquirers, we have applied 50%. For Level 3 (informed by Cobbetts and the earlier case of Halliwells) we have applied a 10% probability, i.e. we will see firm failure but any such firm is likely to be sufficiently attractive commercially to be acquired and therefore not require intervention. Following the application of this probability factor, the number of interventions have been rounded up to the nearest whole intervention.

The application of these probability factors provides a best view of:

- Level 1 – 49 interventions
- Level 2 – 3 interventions
- Level 3 – 0 interventions.

On this best view scenario the cost impact would be (for Element B alone):

- intervention agents and immediate file handling, £3,829,763 (as against a total 2013 budget of £1,285,000); and

- an increase in 2013 file archiving costs from the budgeted figure of £1,600,408 to £3,457,370.

Our low case scenario is based on probabilities of 80%, 25% and 0, resulting in:

- Level 1 – 43 interventions
- Level 2 – 2 interventions
- Level 3 – 0 interventions

On this low case scenario the cost impact would be (for Element B alone):

- intervention agents and immediate file handling, £3,092,869 (as against a total 2013 budget of £1,285,000); and
- an increase in 2013 file archiving costs from the budgeted figure of £1,600,408 to £2,665,192.

The best view of intervention costs for planning purposes

Our total best view for 2013 combines the Element A estimate with the Element B best view. This gives a total best view of predicted costs for 2013 of:

- intervention agents and immediate file handling, £4,907,769 (as against a total 2013 budget of £1,285,000); and
- an increase in 2013 file archiving costs from the budgeted figure of £1,600,408 to £4,989,847.

This creates a funding shortfall, against budget of £7,012,428 (sitting within a range of a worst case of £14,987,785 and a low case of £5,483,355).

The figures quoted above all exclude VAT and are also based on costs all being incurred within 2013 (in reality it is likely that certain costs associated with a 2013 intervention may fall into 2014). The financials are also based on the accounting principle and not on a cash flow basis (for example, a cost will be recognised in the financials in April, however, the actual cash movement in respect of this cost will not occur until May). It should also be noted that for comparability purposes, all 2013 financials presented are based on a 12 month period against the approved 2013 budget.

There are two further assumptions underlying these figures. First, that none of the policy responses aimed at reducing intervention costs will have a meaningful cost reduction impact in 2013. Second, that we continue to apply to the financial stability programme the increased level of internal resources that this work is receiving – primarily through the Supervision, Risk Centre, Forensic Investigation and Enforcement functions. The SRA has shifted resources into this work (in accordance with our risk based approach to apply resources flexibly to address areas of highest risk) and our current view is that this is critical to constraining the level of interventions and intervention costs to the “best view” position.