



BIRMINGHAM LAW SOCIETY
one profession • one region • one voice

**Response to SRA Consumer Protection
Review**

**Paper 3 – Delivering and paying for a
sustainable Compensation Fund**

February 2025

Response of the Professional Regulation Committee of the Birmingham Law Society to the SRA Consumer Protection Review Paper 3 – Delivering and paying for a sustainable Compensation Fund

This response has been prepared by the Professional Regulation Committee of the Birmingham Law Society. The Society is the largest local law society with some 9,000 members from all branches of the legal profession and practising in all aspects of law. The response represents the collective views of the Professional Regulation Committee whose members are specialist lawyers practising in all aspects of professional regulation and compliance for the legal profession. Contributions have also been made by the Birmingham Law Society Council.

Introduction to Response

Birmingham Law Society welcomes the opportunity to participate in this wide-ranging consultation with the SRA but it has huge concerns with the growth in the number and size of recent interventions resulting from misuse of clients' monies. For centuries, solicitors have been trusted to hold client money as an essential part of conducting their clients' business. In the rare event of a solicitor being found to have been dishonest the profession has always been rigorous in taking prompt action and importantly, ensuring that clients do not end up out of pocket. The result has been that trust and confidence in the profession has been maintained. This cannot be taken for granted and the actions or rather the inactions of the SRA have put this in jeopardy.

The causes of the recent increase in large scale firm failures warrants careful scrutiny. A rush towards what might be a superficially attractive solution such as doing away with the client account (which has stood the test of time) is thwart with risks, untold difficulties and would achieve little. We contend that by

removing the client account from solicitors, this would simply transfer the issues to be addressed by third parties who are unlikely to have the same stringent accounts rules that govern solicitors and their regulators whoever they might be. The proposal would be a disaster and would not result in any benefit to clients.

We submit that in making this suggestion the SRA is exceeding its remit. It represents a radical move away from the landscape in which solicitors have to operate. We reject any suggestion that there is pressure for change coming from clients. It must also be recognised that clients are not the only people to be considered. Other interested parties, including financial institutions, make extensive use of solicitors' client accounts in funding of transactions. In our opinion it would be essential to have a full wide-ranging consultation with everyone who might have an interest in or be affected by a change before any proposals could be tabled. There is no sign that there is a loss of trust or pressure for a change, which speaks for itself.

It is difficult not to draw the conclusion that the most significant if not the prime factors that have led to the present difficulties are the direct result of decisions taken by the SRA and systemic failures identified in the independent report of Carson McDowell. Two actions vital for the SRA to take which will go some way towards restoring stability are:

1. The reinstatement of the requirement to lodge an annual independent accountant's report is absolutely essential. The "light touch" is not effective. With rapid advancements in diagnostics technology and AI, this would no longer be unduly burdensome; and
2. Acknowledgment and a willingness to address all the issues identified in the report of Carson McDowell to the Legal Services Board.

If these steps were to be taken, they could be used as the first steps towards restoring a measure of confidence on the part of the profession in the SRA, which it is fair to say has never been lower. This could be an opportunity to move towards an improved working relationship. As it is, the profession is with justification frustrated by having to bear a 270% increase in contributions to the Compensation Fund resulting directly from the SRA's, as yet largely unacknowledged, mistakes.

Response

Q1. Do you agree that changing the apportionment of Compensation Fund contributions to 70% individuals and 30% firms is an appropriate and proportionate approach to setting contribution levels for 2025/26? Please give reasons for your answer.

Claims on the Compensation Fund (“the Fund”) are made when law firms are unable to refund client monies to their clients, usually as a result of dishonesty. The Fund provides a safety net for clients and reassurance that client monies are protected when clients instruct a law firm. The Fund exists to safeguard consumer confidence in the delivery of legal services by law firms. The current drain on the Fund is caused by law firms not individual solicitors. We cannot see any justification therefore for the apportionment of the contributions to be changed.

All individual solicitors (except those working for the CPS) have to pay a contribution to the Fund. Law firms usually pay for their solicitors in any event so it would be robbing Peter to pay Paul so to speak to change the apportionment. The overall bill would remain the same for firms. Where it would hit harder would be for individual solicitors whose firms do not pay for their practising certificate and Compensation Fund contributions – such as in house solicitors for example. The latter do not benefit directly from the existence of the Fund. If the SRA proposals were accepted and individual solicitors’ contributions were increased the individual solicitors would be required to pay these higher payments from their own funds.

The SRA seeks to justify this change by referring to a beneficial reduction in the level of firm contributions for smaller firms but as mentioned above the overall

cost would be the same if the firm pays for its own individual solicitors. The SRA also introduces an argument from its equality and impact assessment about the effect *“on small firms; Black & Asian solicitors, solicitors from lower or intermediate socio-economic backgrounds, those aged 45 and upwards and disabled solicitors”*. Again, this argument does not bear close analysis as the firms for which those individual solicitors work will foot the bill in any event so this proposal is just tinkering with the figures and should be rejected.

Q2. Are there any other important apportionment issues you think we have not considered here? If so, please explain what they are.

See response to Q1 above – no further comment

Q3. What are your views on the possibility of setting differential contribution levels for different firms?

There is a superficial attraction in considering differential contributions levels for different firms in the interests of fairness. However, the cost of setting up and administering any differential system could well outweigh any possible benefit. One could envisage firms disagreeing and challenging any annual assessment of their contribution level. One needs to remember that the contributions to the Fund are a cost of doing business and a benefit to the overall profession. If there are law firms which are a risk to the profession, it is the SRA’s job to root out these firms and take action.

Q4. What are your views on the possible alternative methods of setting differential contributions to the Compensation Fund (based on enhanced requirements, risk categorisation, the amount of client money held, or annual turnover)?

Enhanced requirements – this would be much too complicated to set up and administer and would be subject to challenge.

Risk categorisation – again this is much too complicated to administer and would be subject to challenge.

The amount of client money held – this proposal has merit because of its simplicity but some firms may seek to reduce their client account balances by using Third Party Managed Accounts (“TPMAs”) – as those funds are not classed as client money. It may be a backhanded way for the SRA to reduce the amounts held in client account – on the road to abolishing client accounts. However, it would mean that the contributions to the Fund would plummet if this method was used. Also, the SRA would need independent verification of the amount of client money held rather than relying upon the annual declaration. We have suggested that such information should be included in a revamped template accountants’ report for the purpose of verification/cross checking by the SRA – see BLS response to question 6 in paper 2.

Annual turnover – we are in total disagreement with this “Robin Hood” type suggestion which seems to be designed to cause fragmentation of the profession. Well managed firms with a decent turnover do not trouble the Fund and should not be penalised in this way. There is a cost to operating as a law firm and that cost should be borne equally by those who seek to deliver legal services. The only reason for the current discussion is because of the failure of the SRA to monitor Metamorph, Axiom Ince and SSB Law. If the SRA was to focus upon its core duty of protecting client money and improve its own performance, the Compensation Fund would not have become so depleted.

Q5. Are there other alternative approaches to differential contributions you think we should consider?

No – the SRA should retain the current flat fee arrangement. It is simple to operate and less costly than any of the other suggestions. The Fund also operates on the basis of a reserve so in some years the contributions will reduce – in which case all firms benefit large or small. The Fund should be maintained at a proportionate and stable cost to the profession.

Q6. To what extent do you agree we should move away from the current arrangements that allow us to impose a cap of £5m for connected claims?

We do not agree. The cap of £5m should be retained. It is a discretionary measure in any event and was not adopted for Axiom Ince in the interests of the clients of that firm so debate on this topic is otiose. As a profession, it is important that the discretionary cap continues to exist in order to give an element of certainty going forward, in circumstances where the SRA is increasingly uncertain.

Q7. Would you support any of the other options discussed (a flexible cap for connected claims, removing the cap for connected claims, guaranteeing compensation up to a specified amount)? Please explain why.

No – see response to Q10 below.

Q8. Are there other important considerations you think we have not considered here? If so, please explain what they are.

No

Q9. What are your views on the idea of amending our Compensation Fund Rules to explicitly exclude specific types of claims? If you think specific types of claim should be excluded, which ones are these?

The proposal lacks information on the types of claims that the SRA seeks to exclude. The concept of excluding investment schemes seems attractive at first glance, but further detail is required to consider the implications. The Fund Rules permit the SRA to reject claims for example where the conduct of the applicant contributed to the loss – Rule 11. In our view there is sufficient discretion there to protect the Fund from certain claims. Any list of excluded claims would be difficult to formulate and subject to challenge.

Q10. Are there any other considerations we should take into account in relation to payments from the Compensation Fund? If so please explain what they are.

The Compensation Fund should not be used to fund the regulatory activities of the SRA. The Fund should be used solely to protect the interests of clients, or former clients, of SRA regulated law firms. The Compensation Fund should not be used to cover the costs of interventions, applications to the Fund and the handling/storage of client files from intervened firms.

N.B. The Compensation Fund was used to pay for intervention costs until 2009 and there was then a decision to use Practising Certificate fees. Then in 2013 there was a consultation and a decision made to use the Fund again for intervention costs.

In the year to 31 October 2023, there was a deficit of £29.1m in the Fund – the previous year 2022 there was a surplus of £3.6m. Also, in 2023 the SRA

recharged administrative and intervention costs to the Fund of £20.4m – previous year 2022 it was only £4m.

The SRA should undertake a detailed analysis of these administrative/intervention costs and then consult with the profession. These costs now represent an enormous proportion of the expenditure of the Fund. They are not subject to any check or balance. The profession is under the impression that the Fund is there to reimburse those clients who have lost client money from solicitors' client accounts. However, as the figures above reveal (£20.4m in 2023) the Fund is being used to a large extent to pay for the SRA's regulatory activities – some of which may be justified some may not.

Q11. In the context of this consultation, do you agree with our assessment of equality, diversity and inclusion considerations in our impact assessment? If not, what else do you think we should consider?

No further comment

Birmingham Law Society Professional Regulation Committee

February 2025