Sent by email to consultation@sra.org.uk

21 April 2020

Dear Sir/Madam,

The Legal Services Consumer Panel (the Panel) welcomes the opportunity to respond to the Solicitors Regulation Authority's (SRA) consultation on its proposals to change its Compensation Fund arrangements.

The Panel has considered the proposals carefully, balancing the SRA's need to ensure that the Compensation Fund remains sustainable, with the obligation to provide a safety net for risks which the Professional Indemnity Insurance (PII) is unable to cover. We accept that there is a need to review, adjust and certainly consider the changing nature of risks in the sector. However, after careful reflection, the Panel is of the view that consumers are being asked to take on a disproportionate level of risk, more than the professionals whom consumers are asked to entrust with their money.

Once more the Panel finds itself agreeing with the reasons for re-assessing the Compensation Fund arrangements, including the central objective. But just as we did in 2018[1], we find the means to achieving the objectives wanting. We have outlined some broad concerns below and answered all the consultation questions, also below.

Lack of consumer research and inadequate evidence

It is concerning that yet again the SRA has developed a second rendition of these proposals without consumer research. These proposals would have benefitted from the voices of those who have successfully claimed from the Compensation Fund and from those who have been unsuccessful. The impact on victims must be monitored, measured and understood before the availability of the fund to victims is limited to minimize the cost to the contributions. At the very least, changes to the Compensation Fund should have been informed by consumer research into risk appetite, particularly with regards to lowering the maximum single pay-out from £2m to £500,000.

The lack of consumer research is further compounded by insufficient detail around some of the evidence that the SRA does provide. For example, supporting evidence shows that the SRA closed more than 50 per cent of claims without making a payment. This is a significant number, which raises questions around the reasons for declining these claims. However, the SRA does not provide any analysis around declined claims, yet this insight goes to the heart of evaluating how the fund is operating and serving victims' needs. This analysis would have also informed our thinking around how future amendments are likely to impact consumers.

[1] SRA – Consultation response on PII and Compensation Fund proposals, June 2018.

Perverse driver for change

It is equally worrying that the drive for change stems from the need to mitigate against high cost claims from fraudulent and reckless investment schemes. This is a poor basis for reducing consumer protection. The SRA needs to tackle investment scams or misconduct with its supervisory and enforcement activities, not by cutting off compensation for wrongdoing. Tackling activities that are against the Code of Conduct or patently dishonest is a core function of regulation. It is an abdication of this responsibility to attempt to reduce compensation payment to consumers who have suffered financial loss as a result of misconduct or dishonesty. And it would be a double injustice to be penalised by the very regulator who failed to prevent the wrongdoing. We acknowledge that the SRA cannot predict or guard against every misdemeanour. But to propose to curtail compensation because of that is beyond what we can support, particularly when the SRA has not, in any detail, shown how it plans to tackle these investment schemes.

Danger in eroding public and consumer confidence

The SRA has been at pains to stress that although the Compensation Fund provides an essential safety net for consumers, this is at a cost to the profession and ultimately to consumers. We agree. However, there is an undertone or insinuation that this cost is unreasonable or undesirable and we must challenge this supposition. The Compensation Fund arrangement is beneficial to both consumers and solicitors. While the benefit to consumers is often highlighted, the added confidence that this safety net affords the profession can't be underestimated. It can never be taken for granted that consumers are being asked to entrust solicitors with money running into hundreds of thousands, sometimes millions of pounds e.g. where solicitors offer conveyancing and probate services. The protection for these large sums must be robust. This is the cost of doing regulated business and the added assurance that consumers pay for. And if the cost of contributing to the Compensation Fund is driven up by solicitors partaking in reckless activities, the SRA needs to focus on tackling these activities. Adjustments to how the Compensation Fund operates cannot be to the detriment of those consumers who have been wronged.

Consumers procure legal services for serious matters, often in times of distress. The procurement of these services from solicitors commands high costs from professionals who trade on the brand recognition of being solicitors, and justify their charges based on their training, competence, skills and the protection that is afforded. To erode consumer protection will have a negative impact on trust and confidence in the profession and even the sector. The fund is already limited in that it is discretionary, and it does not purport to put consumers back in the position they would have been if the mischief had not occurred.

Insufficient protection for consumers of conveyancing and probate services

The Panel cannot support the proposal to cap single payouts to £500,000 – a significant reduction from £2 million. This cap is inadequate in some areas of law like conveyancing or probate, and the consultation acknowledges that conveyancing is an area of high claim. A limit set at that level would completely fail to address the potential needs of a significant number of consumers.

Reducing the cost in other areas

The Panel notes with huge interest the cost of interventions, typically where the SRA steps in to close a firm down. The SRA's data shows that intervention cost is a significant drain on the Compensation Fund. The data provided shows that between

2012 and 2016 the Compensation Fund's outgoings on interventions rose from 2.2 to 27.7 per cent. In contrast, expenditure on grants fell from 80.5 to 54.8 per cent. This highlights that in fact what is draining the Compensation Fund is the cost of interventions, not necessarily direct grants.

It is important to note that the SRA only began taking money from the Compensation Fund to pay for interventions in 2013. The Panel strongly believes that the decision to fund interventions from the Compensation Fund is questionable. The Compensation Fund exists to compensate wrongdoing, and in our opinion, it should not be used to fund core regulatory business such as winding down a firm. Again, we go back to our earlier point that this set of proposals could amount to a penalty on consumers for provider and regulatory failure: in this instance, failure by the regulator to ensure that its supervisory and enforcement activities are robust enough to ensure the need for fewer interventions.

Where interventions must occur, their cost should not be borne by the Compensation Fund. We do not know the breakdown of the costs of interventions, because this information is not made available by the SRA. It is our assumption that the bulk of the intervention costs are paid to other professionals contracted to fulfil the practicalities of closing the mismanaged firm. What is certain from the data available, is that if the cost of interventions is removed or reduced, a substantial drain on the Compensation Fund would be reduced.

Response to the consultation questions.

Do you agree that the proposed purpose statement will help people understand the circumstances when a claim is likely to be paid?

The Panel agrees with the rationale for explaining more clearly the purpose of the Compensation Fund. However, we do not agree with the scope of the current definition in so far as it excludes third-party clients. It is our strong contention that third-party clients should not be excluded from being able to access the compensation fund. We elaborate on this in our response to question 4.

Do you agree with our revised proposals to remove hardship tests for all individuals, small businesses, small charities and small trusts?

Yes. The Panel agrees with the proposal to remove the hardship tests for the reasons articulated in the consultation paper.

Do you agree with the proposal that we use our residual discretion to refuse or reduce payments on rare occasions when we consider the loss will be immaterial or substantively compensated elsewhere?

The Panel is against this proposal. Consumers who are successful in making a claim do so because it has been established that the solicitor in question is culpable for their financial loss. Imposing an arbitrary lower limit is against the very essence of compensating for loss.

There is already an upper limit cap on what consumers can claim and we regret that the SRA is proposing to reduce this further. In our view, to further limit payments based on a subjective determination of monetary significance is problematic. We note the SRA's own evidence which shows that most households have less savings with which they could withstand a financial crisis, suggesting that any loss in many households would not be considered inconsequential. More importantly, some of those seeking redress from the Compensation Fund may have been in a financial crisis, or their legal

matter may have depleted their finances substantially. Therefore, what the SRA considers to be immaterial may be substantial in the circumstances.

Finally, the Panel is not clear of the need for this proposal because the SRA already has a discretion to decline compensation if there are other routes to redress. The SRA has also emphasized, consistently, that the Compensation Fund is only available where the consumer has exhausted all other routes. We cannot see any merit in adding what appears to be a sanction for monetary sums that the SRA considers too low, given how difficult that is to objectively quantify.

Do you agree that the Fund should only be available to those who are the clients, or recipients, of the services of the solicitor/firm in question?

No. The Panel is strongly against this proposal. At present, the SRA can and does consider allegations of misconduct made by third-party complainants which can lead to disciplinary proceedings being brought against a solicitor. It is therefore odd that the SRA is proposing to end compensation to these third-party complainants where there is proof of financial loss. This policy is grossly unfair, inconsistent, and is contrary to the SRA's regulatory objective of 'promoting and maintaining adherence to professional principles.' Professional principles which clearly extend beyond the contractual obligation to direct clients. Again, this proposal has the potential to erode public and consumer confidence in the profession.

Cutting off all third-party compensation can lead to unjust outcomes. Sometimes consumers are not treated as the lawyer's client even though the legal work is intended to benefit them. For example, in a re-mortgage, the lender is technically the client, not the homeowner. This blanket ban on all third-party claims will not only lead to consumers losing out unfairly, it will also reduce the incentive to act fairly towards third parties and will dissuade consumers from reporting misconduct, which may curtail intelligence on risks.

It is even more concerning that the SRA has sought to use the position of the Legal Ombudsman to justify this reversal of scope. The Legal Ombudsman has been much criticised for its own approach, which is too narrow and out of step with most modern ombudsman services. In fact, ombudsman schemes in lots of other sectors already consider third party complaints. Moreover, the Legal Ombudsman does accept some third-party cases, it is just confusing to understand which it accepts, and in what circumstances, a point the Panel has asked the Legal Ombudsman to clarify often.

Do you think we should expressly include a right for the client of a solicitor whose actions have caused the loss for which they are liable to make a claim on the Fund, if no other redress is available?

While in theory this may seem sensible, this proposal is fraught with practical difficulties and disproportionate hurdles. As we understand it, the third-party who has suffered a loss must first pursue the client of the solicitor for the loss, even when it is not the client's dishonesty that has led to the loss. In turn, the client of the solicitor can seek compensation from the fund to compensate their own loss. This is a convoluted and long-winded approach which would add unnecessary cost, delay and stress to consumers.

Do you agree with the proposal to introduce a multiple application cap?

No. As noted above we are of the view that the multiple application cap is being introduced to address fraudulent and reckless investment schemes. Such schemes need to be tackled with stricter supervision and effective enforcement measures. The

SRA's proposals would penalise those who might have a legitimate claim against the fund. We cannot support this proposal because the risk to consumers is that, where very large losses arise, there is a possibility that individual claims may not be met.

Do you agree that we set a financial threshold of £5m? Please provide any available evidence to support your response.

The Panel believes this is a finely balanced issue.. We note that in conveyancing, aggregate claims can quickly exceed £5 million. We are also concerned about systematic and fraudulent or negligent activity in a firm. However, we accept that a cap on multiple claims may be necessary in some circumstances. However, we do not agree with this arbitrary figure. Again, we note that there is nothing to aid our decision making here. The SRA has not provided data or analysis of aggregate historical claims. We don't know how many cases would have been captured by this sum, or how many would have fallen outside of it. In fact, we do not know why the SRA considers £5m to be an appropriate figure. It may sound reasonable, but we cannot be sure that it is, and it is reasonable to insist that any regulatory change of this nature should only be introduced on the basis of relevant evidence.

Do you have a preference for any method of apportionment or that we retain the option to apply any of these depending on the circumstances?

If these proposals go ahead, we believe the SRA should retain the option to apply any method of apportionment depending on the circumstances of the case.

Do you have any other comments on the features of the proposal to cap multiple claims?

No

Do you agree with the revised approach to how we will apply the single application limit?

No. We do not agree with a cap on single claims which would represent a reduction from £2m to £500,000. We accept that the SRA intends to exercise a discretion to award greater sums in certain circumstances, however, on balance, we cannot support placing such a risk on consumers. Moreover, there is little transparency around how the Compensation Fund currently operates, which further bolsters our opposition to a cap mitigated only by the SRA's discretion.

We accept the SRA's data and evidence which shows that the average grant from the Compensation Fund is £20,000 and 75 per cent of grants are under £5,000. The SRA has argued that the impact of the reduction would be small because few claimants seek above £500,000 in compensation. Conversely, this suggests that it is the smaller but larger volume claims that have an impact on the Compensation Fund. Moreover, while the number of claimants seeking above £500,000 may be small, the impact of the cap on those claimants is likely to be significant.

The fact remains that those seeking compensation are those who have been defrauded by their solicitor. It is disappointing that the SRA's insight into what other regulators do focused heavily on other legal services regulators, yet the Council for Licensed Conveyancers which also regulates a high claim area of law (conveyancing) does not have an artificial cap in place. We believe that the SRA should seek to emulate best practice for consumers from outside of the legal services sector. For example, the Financial Conduct Authority recently announced that the Financial Ombudsman

Scheme will **increase** its maximum payout, and this will be automatically adjusted every year to ensure compensation keeps pace with inflation.

Do you have any other comments on the proposals and impacts we have set out in the consultation? Are there any impacts particularly equality diversity and inclusion impacts that you think we have not identified?

The Panel is concerned about the proposal to withdraw funding from claimants who seek professional support in making an application. We can foresee this blanket policy negatively affecting vulnerable consumers. In our view, this proposal is directly opposed to the regulator's duty to protect the interest of consumers and improve access to justice. Some consumers will need independent and paid for support, especially at a time when free advice services and support is dwindling and overstretched.

The SRA is also proposing to cut off compensation where a solicitor's PII provider is insolvent, in cessation, or the practitioner's policy qualifying insurance has been disclaimed. At the time of drafting and publication, there is no doubt that the SRA thought these circumstances would be rare. The situation created by Covid-19 however may make this less rare. It is concerning that a regulator with a duty to protect consumers' interests considers it appropriate to create a situation where there is no insurance and no compensation in place.

Conclusion

Overall, we are of the view that these sets of proposals are poorly designed. We believe that the main mischief the SRA seeks to guard against should be controlled with improved monitoring and enforcement actions – better regulation. Consumers are being asked to relinquish significant protection without any benefits. We are not convinced that a reduction in the cost of legal services as a result of these changes would be passed on to consumers. We are not even convinced it will materialise.

I hope you find these comments helpful. Please contact Lola Bello, Consumer Panel Manager, if you have any enquiries

Yours sincerely,

Sarah Chambers

Chair

Legal Services Consumer Panel