



## **Legal Services Board – Decision Notice issued under Part 3 of Schedule 4 to the Legal Services Act 2007**

### **The Solicitors Regulation Authority’s application for approval of its Determination of Compensation Fund Contributions 2012 and Determination of Compensation Fund Contributions for Licensed Bodies 2012**

The Legal Services Board (LSB) has approved the application by the Solicitors Regulation Authority (SRA) for it to alter the Compensation Fund contributions for the practising year 2012/13, to be set out in the Determination of Compensation Fund contributions [2012] for individuals and firms and the Determination of Compensation Fund contributions for Licensed Bodies [2012]. This Notice sets out the basis for the LSB approval and the decision taken, including a brief description of the changes.

#### **Introduction**

1. The LSB is required by Part 3 of Schedule 4 to the Legal Services Act 2007 (the Act) to review and grant (in whole or part) or refuse applications by approved regulators to make alterations to their regulatory arrangements. The Law Society is an approved regulator and the SRA is the regulatory arm to which The Law Society has delegated its regulatory functions.
2. Paragraph 25 of Schedule 4 to the Act explains that the LSB may only refuse an application setting out a proposed change to the regulatory arrangements if it is “...satisfied that...” by granting the application one or more of the criteria specified in the sub paragraphs of 25(3) (and listed in the footnote below<sup>1</sup>) will be met. For example, the LSB’s granting of the application to alter the regulatory arrangements must not be prejudicial to the regulatory objectives overall. If the LSB is not satisfied that one or more of the criteria for refusal are met, then it must approve the application in whole, or the parts of it that can be approved.
3. As provided for by paragraphs 20(1) and 23(3) of Schedule 4 to the Act, the LSB has made rules<sup>2</sup> about how the application to alter the regulatory arrangements must be made including the contents of that application. The rules highlight the applicant’s obligations under section 28 of the Act to have regard to the Better Regulation Principles. The rules also require that the applicant provides information about the

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<sup>1</sup> The Board may refuse the application only if it is satisfied that—(a) granting the application would be prejudicial to the Regulatory Objectives, (b) granting the application would be contrary to any provision made by or by virtue of the Act or any other enactment or would result in any of the designation requirements ceasing to be satisfied in relation to the approved regulator, (c) granting the application would be contrary to the public interest, (d) the alteration would enable the approved regulator to authorise persons to carry on activities which are reserved legal activities in relation to which it is not a relevant approved regulator, (e) the alteration would enable the approved regulator to license persons under Part 5 to carry on activities which are reserved legal activities in relation to which it is not a licensing authority, or (f) the alteration has been or is likely to be made otherwise than in accordance with the procedures (whether statutory or otherwise) which apply in relation to the making of the alteration.

<sup>2</sup> [http://www.legalservicesboard.org.uk/what\\_we\\_do/regulation/pdf/rules\\_for\\_rule\\_change\\_applications\\_v2\\_November2010.pdf](http://www.legalservicesboard.org.uk/what_we_do/regulation/pdf/rules_for_rule_change_applications_v2_November2010.pdf)

nature and effect of each proposed change and of appropriate consultation undertaken. Sub paragraph 25(3)(f) of Schedule 4 to the Act requires that each proposed alteration has been made or is likely to be made in accordance with the procedures (whether statutory or otherwise) which apply in relation to the making of the alteration. This therefore includes the LSB's rules.

4. The chronology for the LSB's handling of this application can be found towards the end of this Decision Notice.

## Decision

5. The LSB has decided to grant this application by the SRA for it to alter the Compensation Fund contributions for the practising year 2012/13 as set out in the draft Determination of Compensation Fund contributions [2012] (see Annex 1) and the draft Determination of Compensation Fund contributions for Licensed Bodies [2012] (see Annex 2).

### *Compensation Fund levels*

6. In August 2010, the LSB approved changes to the SRA's Compensation Fund structure. Accordingly, from 2010, 50 per cent of the total requirement for the Compensation Fund was collected from individuals and 50 per cent was collected from firms. The 2011 and 2012 Compensation Fund contributions have been calculated on this basis.
7. For the 2012/13 practising year, the proposed Compensation Fund contributions for individuals will be £92 (compared to £60 in the 2011/12 practising year) and £1340 for all entities, including licensed bodies, (compared to £772 in the 2011/12 practising year). As for 2011/12, if a new firm is set up during the 2012/13 practising year, the SRA proposes that firm will pay a pro rata Compensation Fund contribution according to the quarter in which the firm is set up.

### *Composition of the Compensation Fund*

8. As the 2012/13 Compensation Fund contribution levels are calculated using the same methodology that the LSB approved in 2010, the LSB has no concerns regarding the approach the SRA has taken this year. The LSB has, however, noted that the substantial increase in the funding requirement and the consequent increase in Compensation Fund contributions is not consistent with the SRA's assertion that fees should be "stable – charges should not vary considerably year-on-year"<sup>3</sup>.
9. The SRA has calculated that it needs to collect £21.9 million in contributions for the Compensation Fund in 2012/13 (£13.5 million in 2011/12). In its application, the SRA states that this is due to the increase in the value of open claims on the Compensation Fund in recent months (primarily due to mortgage related claims) which are relatively high in comparison with previous years. In light of this, the SRA considers that a cautious approach is required to the level of reserves in order to

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<sup>3</sup> The SRA principles are contained within the new fees policy agreed for 2010/11 which can be found at <http://www.sra.org.uk/solicitors/pc-registration-renewal/fees/fee-policy-2010-2011.page>

ensure that the Fund can function effectively and provide protection for consumers. The calculation of the minimum acceptable reserve has been refined to use the weighted average of grants paid, putting greater emphasis on more recent claims experience to assess future risk. A significant increase in the Compensation Fund contribution was preferred to potentially requiring a further contribution from firms and individuals later in the year.

10. The LSB understands the underlying rationale for needing to cover potential calls on funds, in particular to ensure there are sufficient funds to protect consumers. However, the LSB also considers that significant fluctuations in the level of the contribution should not be driven primarily by the particular funding strategy. It should, ideally, be determined by the actual and potential liabilities on the Compensation Fund. Moreover, the further substantial increase in the Compensation Fund contribution does not appear to be consistent with the intended plan for the Compensation Fund set out in the SRA's 2011/12 application. In the 2011/12 application the SRA explained that the lower fees in 2010/11 were due to a plan to reduce the Compensation Fund's reserves to a level close to the prudent minimum level. It said that the decision to collect £13.5 million in 2011/12 was part of a plan to provide a more stable level for the contribution fees over the next three years. The plan was based on the SRA's claims experience and the forecasting of claims for the next year. We note that the SRA's strategy has not delivered the stability in contribution levels that it had anticipated.
11. We note that the SRA is proposing to undertake a fundamental review of compensation arrangements for implementation in 2014/15. The LSB would like to be kept informed of the scope, timetable and progress of this review.

#### *Communication with stakeholders*

12. Given that the SRA needed to increase the Compensation Fund contributions, it embarked on a communications programme that used different media to explain the rationale behind its decision to the regulated community. This included:
  - The publication of the online calculator, including a brief reference to the Compensation Fund, which was communicated via the legal media.
  - A news release which was also tweeted.
  - Reference to the calculator in the SRA's e-newsletter that goes to everyone with a mySRA account.
  - A news release issued at the beginning of July 2012 to the legal media.
  - Building key into any public speaking opportunities and appropriate presentations.
  - A placement article covering both the fees calculator and the Compensation Fund which was sent to stakeholder groups to include in their publications.
  - Reference to the fees exercise was also made within the trade press.
13. The SRA advised that no responses were received about the proposed increase in the Compensation Fund contributions. The online calculator was updated in mid May 2012 with more realistic contributions figures and a letter sent to all firms to let them

know it had been updated. The SRA said that there had been a few general queries about the reasons for the uplift but no complaints.

14. The LSB is content that the SRA has adequately informed its regulated community, and has made available information, of the likely increase in the 2012/13 Compensation Fund contributions.

### **Chronology**

- The LSB confirmed receipt of an application from the SRA on 9 July 2012.
- The 28-day decision period for considering the application will end on 6 August 2012.
- This Decision Notice will be issued to the SRA on 1 August 2012.
- This Decision Notice will be published on the LSB's website on 2 August 2012.

**Crispin Passmore, Strategy Director**  
**Acting under delegated authority granted by the Board of the Legal Services Board**  
**1 August 2012**

## **Annex 1 - Determination of Compensation Fund contributions [2012]**

This determination is made by the Solicitors Regulation Authority Board under rule 2.6 of the SRA Compensation Fund Rules 2011, with the approval of the Legal Services Board under paragraph 19 of Schedule 4 to the Legal Services Act 2007.

- (1) Every person who applies for a practising certificate to commence on or after 1 November 2012, or who applies for initial registration or renewal of registration as a registered European lawyer or registered foreign lawyer to commence on or after 1 November 2012, shall pay with the fee payable in respect of that application, a contribution of £92 to the Fund.
- (2) Every recognised sole practitioner that:
  - (a) applies for renewal of authorisation as a recognised sole practitioner to commence on or after 1 November 2012; and
  - (b) has held or received client money (as defined in the SRA Accounts Rules 2011) during the period 1 November 2011 to 31 October 2012 shall pay with the fee payable in respect of that application, a contribution of £1340 to the Fund.
- (3) Every recognised body that has held or received client money (as defined in the Solicitors Accounts Rules 2011) during the period 1 November 2011 to 31 October 2012, shall pay with the annual periodical fee, a contribution of £1340 to the Fund.
- (4) Every person that:
  - (a) applies for initial authorisation as a recognised sole practitioner or initial recognition as a recognised body to commence during the period 1 November 2012 to 31 October 2013; and
  - (b) intends to hold or receive client money (as defined in the SRA Accounts Rules 2011) at any time during the period 1 November 2012 to 31 October 2013shall pay with the fee payable in respect of that application, a contribution to the Fund as follows:
  - i. £1340 on applying for initial recognition to commence in the period 1 November 2012 to 31 December 2012;
  - ii. £1005 on applying for initial recognition to commence in the period 1 January 2013 to 31 March 2013;
  - iii. £670 on applying for initial recognition to commence in the period 1 April 2013 to 30 June 2013;
  - iv. £335 on applying for initial recognition to commence in the period 1 July 2013 to 31 October 2013.
- (5) The SRA may waive the contribution payable under paragraph (4) above in circumstances where the initial application is made by a body which is changing its legal status or is succeeding to the practice of another recognised body or

recognised sole practitioner and the predecessor body or practitioner has already paid a contribution to the Fund.

(6) In this determination:

**Fund** means the Solicitors' Compensation Fund established and maintained under rule 2.1 of the SRA Compensation Fund Rules 2011; and

All other terms are to be interpreted in accordance with the Practising Certificate Fee Determination 2012.

(7) This determination shall come into force on 1 November 2012.

## **Annex 2 - Determination of Compensation Fund contributions for Licensed Bodies [2012]**

This determination is made by the Solicitors Regulation Authority Board under rule 2.7 of the SRA Compensation Fund Rules 2011, with the approval of the Legal Services Board under paragraph 19 of Schedule 4 to the Legal Services Act 2007.

- (1) Every licensed body that held or received client money (as defined in the SRA Accounts Rules 2011) at any time from the date on which the body was authorised to 31 October 2012, shall pay, with the annual periodical fee, a contribution of £1340 to the Fund.
- (2) Every licensed body that intends to hold or receive client money (as defined in the SRA Accounts Rules 2011) at any time from the date on which the body is authorised to 31 October 2013, shall pay, with the initial periodical fee, a contribution to the Fund as follows:
  - i. £1340 on being authorised in the period to 31 December 2012;
  - ii. £1005 on being authorised in the period 1 January 2013 to 31 March 2013;
  - iii. £670 on being authorised in the period 1 April 2013 to 30 June 2013;
  - iv. £335 on being authorised in the period 1 July 2013 to 31 October 2013.
- (3) The SRA may waive the contribution payable under paragraph (2) above in circumstances where the initial application is made by a body which is changing its legal status or is succeeding to the practice of a recognised body or recognised sole practitioner and the predecessor body or practitioner has already paid a contribution to the Fund.
- (4) In this determination:

**Fund** means the Solicitors' Compensation Fund established and maintained under rule 2.1 of the SRA Compensation Fund Rules 2011; and

All other terms are to be interpreted in accordance with the Licensed Body Fee Determination 2012.
- (5) This determination shall come into force on 1 November 2012.