

## Client Protection Review 2018/19

14 December 2020

Read in Welsh [\[https://upgrade.sra.org.uk/sra/how-we-work/archive/reports/201819-mewn-adolygiad/adolygiad-or-drefn-amddiffyn-cleientiaid-201819/\]](https://upgrade.sra.org.uk/sra/how-we-work/archive/reports/201819-mewn-adolygiad/adolygiad-or-drefn-amddiffyn-cleientiaid-201819/)

### Our approach to Client Protection

If we know that people are at risk of receiving legal services from a dishonest solicitor, or it is, for some other reason, necessary to protect the interests of clients, we can take action and close down a firm or a solicitor's practice. We call this an intervention.

When we intervene, we take possession of all client money and files and take steps to return them to their owners. The firm is then no longer able to operate.

#### Why we intervene

There are many reasons why we might intervene into a firm. For example, if the firm becomes insolvent or bankrupt, or if it has been abandoned.

The most common reasons for intervention are:

- we suspect someone in the firm has been dishonest
- there has been a serious breach of our rules
- we need to protect the firm's current, former or future clients.

If we know that solicitors have been dishonest, we are very likely to intervene into their practice. Dishonest solicitors are a serious risk to their clients, the courts and the public.

#### Interventions in the past decade

The number of interventions peaked following the recession of 2008, which saw us intervene into many firms reliant on residential conveyancing. This was an area of work badly affected by the economic downturn. After a fall in 2010/11, the number of interventions has settled at a relatively constant rate for the last eight years, with an average of 43 per year.

#### Number of interventions 2009-2019

2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
74	56	42	50	51	40	37	50	33	37

#### Reasons for intervening

As with previous years, around half of all interventions we carried out in 2018/19 were because we suspected someone in the firm of dishonesty or to protect the interests of clients.

Reasons for 50 interventions in 2016/17	Reasons for 33 interventions in 2017/18	Reasons for 37 interventions in 2018/19
Breaches of our rules	29 Suspected dishonesty	19 Suspect dishonesty
Suspected dishonesty	29 Breaches of our rules	17 Interests of clients
Breaches of our Accounts Rules	27 Protect interests of clients	15 Breaches of our rules
Protect interests of clients	26 Breaches of our Accounts Rules	11 Breaches of our Accounts Rules
Breaches of Solicitors Indemnity Insurance Rules	14 Abandoned	1 Bankrupt
Bankrupt	2 Insolvency of LLP	1 Abandonment
		20
		18
		12
		7
		2
		1

Struck off or suspended	2	Has failed to comply with any condition	1
Incapacitated	1	Struck off or suspended	1
		Committed to prison	1

Please note, each intervention can have more than one reason for intervening.

### **Case study: Intervention in action**

Last year, we closed down a firm offering services in family law, conveyancing, probate, and debt recovery. Our forensic investigation found that one of the firm's partners had been transferring money from the client bank account to meet the firm's running costs. The partner claimed that this money was owed to the firm as payment for its services. This was untrue. The partner had overcharged clients and misled our onsite investigator about the charges. In one of the cases, a client had been charged £23,500 when the work was initially quoted as costing just less than £1,000. We identified a shortage of at least £105,000 on the client account.

We intervened on the grounds that we had reason to suspect dishonesty on the part of one of the firm's partners and that they, and the other partner in the firm, had breached our regulations and Accounts Rules.

We recovered more than £540,000 from the firm's client account and returned it to its owners. We also made grants from the compensation fund totalling £435,000 to clients whose money we were not able to recover. This included grants made to a number of vulnerable clients who had been charged excessive fees.

Both partners were referred to the Solicitors Disciplinary Tribunal (SDT). One was struck off and the other was suspended for one year. They were ordered to pay costs of £34,800 and £14,900, respectively.

### **How the compensation fund works**

The fund can make payments to members of the public and small businesses to replace money taken or improperly used by their solicitor.

Usually, people make a claim on the fund after we have intervened into a law firm they were using. We manage the fund and law firms and solicitors pay into it through an annual levy.

Due to the forecasted risks in the legal sector, we increased the levy in 2018/19 and collected £90 from each solicitor and £1,680 from each law firm. However, as we saw the number and complexity of interventions fall, we went on to decrease the levy to £60 per solicitor and £1,150 per firm for 2019/20.

### **Making a claim**

People can make claims on the fund through our website, and we actively direct people to it when we intervene into a firm. Once we receive a claim, we assess whether the fund can help. People making a claim are often in difficult or distressing circumstances, so we work as quickly and as supportively as we can.

We consider each claim carefully and will only make a payment if the claims fall within our rules and the member of public or small business concerned has suffered a financial loss.

The two most common reasons we make payments are:

- in probate, when dishonest solicitors take someone's inheritance
- in conveyancing, when dishonest solicitors take or lose deposits, mortgage advances or sale proceeds.

There are some circumstances where we are likely to refuse a claim. For example, if the claim:

- should be dealt with by the firm's insurer



- is from a business with a turnover of £2m or more per year\* [\[#note\]](#)
- is for losses resulting from activity that is not part of the usual business of a solicitor
- is made outside the time limit
- arises from the client not taking proper care of their money.

We monitor the amount paid out from the compensation fund each year and the type of claims we receive, keeping an eye on emerging risks to the public and their finances.

In the [consultation for our Business Plan 2020/21](#)

[\[https://upgrade.sra.org.uk/sra/consultations/consultation-listing/business-plan-2020-21/\]](https://upgrade.sra.org.uk/sra/consultations/consultation-listing/business-plan-2020-21/), we consulted on the proposed principles that our Board will consider when setting the level of compensation fund contributions in the future. These include making sure that contributions to the fund are as manageable as possible for the people and firms we regulate and being transparent about how the fund is managed. The overriding principle will be to maintain the viability of the fund. [We received general support on our proposed principles and our commitment to keep the fund viable](#) [\[https://upgrade.sra.org.uk/globalassets/documents/sra/board-meetings/2020/responses-document-for-business-plan-consultation.pdf?version=4a9d3d\]](https://upgrade.sra.org.uk/globalassets/documents/sra/board-meetings/2020/responses-document-for-business-plan-consultation.pdf?version=4a9d3d), and our Board will consider these principles when they set the contributions in 2021. As part of our ongoing work to review its stability and future demands, we will consider all the feedback we received during the consultation process.

\*In July 2020, we announced changes to the compensation fund that will see this reduce to £500,000, subject to the Legal Services Board's (LSB) approval. More information can be found in the [future work section](#) [\[#future\]](#).

## Compensation fund grants in the past five years

The payments we make each year correlate with the number and nature of interventions we have carried out, some of which may have taken place the previous business year. They will also depend on the value of individual claims.

The total value of payments made in 2018/19 was £7.5m. Although this is the lowest amount we have paid out in the last five years, it follows two years of where payments from the compensation fund increased, so it is too soon to know whether this is indicative of a trend.

## Number of interventions and total compensation fund payments 2014-2019

	Compensation fund payments 2014-2019	Number of interventions
<b>2014/15</b>	£17.8m	40
<b>2015/16</b>	£10.3m	37
<b>2016/17</b>	£15.2m	50
<b>2017/18</b>	£18.1m	33
<b>2018/19</b>	£7.5m	37

### Headline figures for 2018/19 are:

- 1,425 claims made
- 1,553 claims closed\* [\[#claims\]](#)
- 488 claims that led to a payment
- total value of payments made was £7.5m
- the largest compensation fund grant was £794,000.

\*Please note, not all of these will be the same group of claims as those made in 2018/19, as not all claims are made and closed are dealt with in the same time 12-month period.

## Managing client money, files and claims to the compensation fund

When we intervene into a firm, we remove all files from its offices and contact the clients to explain what has happened. We work with our intervention agents to take responsibility for the client money in a firm's accounts and the client files.

Our agent, a law firm, will deal with urgent client matters. It will also identify who the files belong to, so that we can contact the clients and let them know that we have closed the firm. The agent also advises the clients on what they should do next.

If a client's file does not need urgent action or is dormant, we will archive it in our facilities in Coventry or Darlington. Our archives are managed by Capita. It deals with all requests from clients for their papers.

We analyse and reconstruct the accounting records for the firm and work to return the client money to its owners. Money is often missing from the client account. In these situations, clients who have not received their money can make a claim to the firm's insurers or to the compensation fund.

### **Holding money on trust and recovering costs**

If we are not able to return client money to its owner shortly after closing down a firm, we keep it in a statutory trust. We take steps to look for the owner, which will depend on how much information we have about the person and the amount of money involved. For large sums, we go to great lengths to find people, including hiring enquiry agents and visiting people's houses to deliver a cheque. Sometimes, the people we are looking for are overseas, so we instruct foreign enquiry agents.

We try to recover the costs of intervening, the payments we make from the compensation fund, and court and internal investigation costs from the firm involved. Our funding comes from the law firms and the solicitors we regulate, so recovering costs is important as, ultimately, our costs are passed onto the public who buy legal services. We pursue all avenues in recovering costs, including taking action against the intervened solicitors or managers, the firm's insurer and, in certain cases, the firm's former partners and directors.

In 2018/19, we recovered £2.5m in intervention costs and payments from the compensation fund.

### **Case study: Largest compensation fund grant**

Our largest individual grant from the compensation fund in 2018/19 was for £794,000 and related to a conveyancing transaction. A law firm, initially offering services in immigration work, was approached by someone claiming to be a solicitor. They had stolen the identity of an actual solicitor so that they could infiltrate the firm. They told the owner of the firm that they could bring conveyancing work into the practice, but, having joined the practice, they then used their position to take client money.

The firm secured conveyancing work and the person claiming to be a solicitor acted in the sale of a property worth £930,000. Two days after completion, they fabricated Land Registry documents and a completion statement to mislead the owner of the firm into making proceeds of sale payments to unconnected third parties. We started investigating after the firm's manager made a report to us about the conduct of the person who claimed to be a solicitor.

We intervened into the firm on the grounds that the firm's manager had breached our rules, and that it was necessary to protect the interests of clients of the firm.

We referred the case to the SDT, where the firm's manager was struck off and ordered to pay costs of £15,000. While the SDT did not find them dishonest, it did find that the only appropriate and proportionate sanction was a strike off, 'given the level of recklessness and lack of integrity displayed', it said.

The £794,000 grant from the compensation fund was made to one of four people involved in this conveyancing transaction who suffered a loss due to the actions of the person claiming to be a solicitor. The others also received grants from the compensation fund for their missing money.

We regularly work with law enforcement agencies and other authorities where we see potential criminal activity. It is important to us that we take all the steps we can to protect the users of legal services.

## The rising threat of dubious investment schemes

Fraudsters are always coming up with ways to win people's trust and take advantage of them. They often present investment opportunities offering excellent returns as a means to take people's money – such as their pension pot. These schemes can be particularly attractive in today's economy.

The schemes may try to use real law firms as middlemen to make dubious investment schemes seem legitimate, trustworthy and safe.

Although the vast majority of solicitors act with honesty and integrity, a small number abuse their position of trust or take risks by assisting in schemes they do not understand. Some people have lost their life savings. Losses reported to us linked to dubious investment schemes over recent years run into the hundreds of millions.

## Types of schemes

Dubious investment scheme sellers tend to change the nature of the schemes they are involved with on a periodic basis, no doubt to avoid detection, as our [latest warning notice](https://upgrade.sra.org.uk/solicitors/guidance/investment-schemes-including-conveyancing/) [<https://upgrade.sra.org.uk/solicitors/guidance/investment-schemes-including-conveyancing/>] and [thematic review](https://upgrade.sra.org.uk/sra/how-we-work/archive/reports/investment-schemes-that-are-potentially-dubious/) [<https://upgrade.sra.org.uk/sra/how-we-work/archive/reports/investment-schemes-that-are-potentially-dubious/>] highlight.

We found that the types of dubious investment schemes which solicitors are most likely to become involved with can, typically, be categorised into four areas:

- Fractional developments, such as individual rooms, spaces or units within wider schemes. We see no obvious reason why someone who wants to invest in a hotel business should buy a room by way of expensive conveyancing, nor why such a scheme would provide high returns.
- Alternative investments, such as precious metals and fine wines. Products like diamonds and wine can be bought and sold, but there is no special way to make a high return.
- Complex financial products, such as loans, shares and bonds that offer high yields.
- Buyer-led developments or refurbishments. The developments are generally sold off-plan, with investors funding the entire project. Such schemes are not inherently fraudulent, but they are high risk and should be treated with caution by the solicitor.

In recent years, we have seen a significant increase in reports linked to off-plan and fractional investments, especially linked to a number of collapsed developments schemes in the north west of England.

This is not an exhaustive list, and new types of dubious investment schemes are appearing all the time.

## Case study: Dubious investment schemes

We prosecuted a solicitor at the SDT in 2019 when we found that they had facilitated dubious investment schemes and had allowed their client account to be used like a bank account, which is not allowed under our rules. Law firms should only have money in their client account which relates to an underlying legal transaction or forms part of the firm's normal regulated activities.

The schemes in question were those promoting complex financial products. In one scheme the solicitor worked on, a member of the public was told they could secure a banking instrument (such as a loan or credit) worth \$50m if they could prove they had £100,000, which was also the cost of progressing the next steps of the scheme. Four clients each gave the firm between £47,000 and £200,000 towards the supposed investments.



The solicitor admitted to breaches of the money laundering regulations and acting dishonestly. This was in addition to admitting that they had facilitated dubious investment schemes and allowed their client account to be used as a banking facility.

The SDT struck off the solicitor and asked them to pay our costs of £24,000. It noted that the solicitor, whose practice had been in financial trouble, had been the 'perfect target' as a middleman to promote the schemes. It also said that the solicitor 'had been experienced and so should have known from the start that what he was doing was wrong. [The solicitor] had clearly intended to benefit financially from the arrangements.'

## Future work

### Principles on setting contribution levels

We consulted on proposed principles that our Board will consider when setting the level of compensation fund contributions in the future. These principles are:

- The overriding principle will be to maintain the viability of the fund.
- We will ensure that the professional contributions to the fund are as manageable as possible for those we regulate.
- We will collect the contributions to the fund in a way that is manageable for those we regulate.
- We will be transparent about the fund monies and their management.

We received general support on our proposed principles and, as part of our ongoing work to review the fund's stability and future demands, we will consider all the feedback we received during the consultation process. Our Board will start applying these principles in 2021, when the next contribution fee for the compensation fund is set.

### Changes to the compensation fund and our Corporate Strategy 2020-23

November 2020 marks the beginning of our new three-year Corporate Strategy. One of the three objectives will be setting and maintaining high professional standards for solicitors and law firms as the public would expect and making sure we provide an equally high level of operational service.

The compensation fund is, of course, a core part of this operational service. It is becoming exposed to changing risks and it is important that we keep its purpose under review against the backdrop of the changing legal market and expectations of the public.

Following two consultations, [one in 2018/19](https://upgrade.sra.org.uk/sra/consultations/consultation-listing/access-legal-services/?s=c) and [one in 2019/20](https://upgrade.sra.org.uk/sra/consultations/consultation-listing/comp-fund-reform-2020/?s=c), we will be [making changes to how the compensation fund operates in the future](https://upgrade.sra.org.uk/sra/consultations/consultation-listing/comp-fund-reform-2020/?s=c). This is so that the fund can continue to protect the public while remaining affordable for the profession and their clients.

The key changes include removing any financial or hardship tests for eligible applicants, so that the people seeking grants no longer need to prove that they have suffered due to their loss. This is because the current test could have prevented clients being compensated.

In addition, the maximum payment for a single grant will be reduced from £2m to £500,000. Only 0.2% of all payments over the last 15 years have been for more than this amount. We have, however, included provision to pay out more than the new maximum in exceptional circumstances.

The oversight regulator, the LSB, is expected to approve the changes in 2021.

### New intervention panel

In October 2020, we invited firms to submit applications to become part of our new intervention panel. When we intervene and close down a practice, the law firms on our panel deal with urgent client matters, work to identify to whom files belong and to contact their owners, and advise clients on what they should do next.

We will carry out a rigorous and thorough tender exercise and announce the new panel in spring 2021.