

Date	23 February 2023
Item	9.0
Title	Entity Regulation and Compensation Fund Report
Author	Vicky Purtill, Chief Operating Officer & David Pope, Director of Operations
Purpose	This paper provides the Board with an update on the Law Firm in a Box proposal and on possible options for replacing the Compensation Fund.
Recommendation	To DISCUSS the update.
Timing	The proposal for 'Law Firm in a Box' can only be developed once the CILEX/CRL dispute has been determined. The interim compensation fund review with CILEX is due in March 2023.
Impact assessment	The proposal for Law Firm in a Box and the continuation of the compensation arrangements have the potential to provide benefits to consumers, contribute to a more diverse profession and increase competition in the legal sector. However, the central risk to the proposal relates to the inability of CRL to progress the proposal whilst its future remains uncertain.
Impact on Regulatory Objectives	The continuance of entity regulation at CRL would have a positive impact on the following regulatory objectives: <ul style="list-style-type: none"> - Public interest - Access to Justice - Consumer interest - Independent, strong, diverse profession - Competition
Implications for resources	The detail of the resources has yet to be scoped. However, CRL considers that this product could be developed to ensure commercial viability based on preliminary discussions with some suppliers and the responses received through CRL's research.
Impact on consumer empowerment	CRL considers that the proposal would promote consumer empowerment by ensuring Transparency requirements are fully and effectively addressed by prospective firms.
Impact on ongoing competence	N/A
Publication status	Not for publication at this stage, but papers in relation to Law Firm in a Box will be shared on a confidential basis with the LSB after the Board meeting.
Appendices (in supporting papers pack)	9.1 COMMERCIALY SENSITIVE

Introduction

1. This paper provides the Board with the current position in relation to the proposal to introduce 'Law Firm in a Box' in accordance with the Strategy Implementation Plan. It also provides the Board with an update on the work that CRL has undertaken since the last Board meeting in relation to the options to replace the interim compensation arrangements.

2. The Board is asked to note that CRL is required to provide CILEX with an update in March 2023 on the development of alternative proposals for the compensation arrangements.

Research

3. In the summer of 2022, CRL commissioned IRN-Spinnaker to undertake research into market appetite for the 'Law Firm in a Box' proposal and the use of Third-Party Managed Accounts. The outcome of the research was first reported to the Board in September 2022 and the research has been attached to this report for reference (**COMMERCIALY SENSITIVE**).
4. The purpose of the research was as follows:
 - a. To propose the replacement for firms holding client money with the use of an escrow (Third-Party Managed Account or TPMA), which would address the issues with CRL's current compensation arrangements, and
 - b. To determine appetite for more regulatory support for lawyers seeking to set up their own firm and pre-packaged access to PII.
5. Whilst the research into the use of TPMA seemed to provide a promising solution to the compensation fund issues, the subsequent consultation with stakeholders identified significant concerns with the proposal for some CRL regulated firms (primarily for firms who have high volumes of low value transactions and those that receive and issue cheques). As a result of the consultation, CRL and CILEX agreed to extend the existing interim arrangements for the CILEX Compensation Fund for up to 12 months and CRL agreed to explore other options over the following six months. This is addressed later in the paper (see paragraphs 13-14 below).

Update on 'Law Firm in a Box'

6. The second part of the research explored the attractiveness of the Law Firm in a Box proposal. The research indicated that there remained strong support for the proposal, although there was some evidence from established sole solicitor practitioners that they supported the SRA brand and would not want to switch regulator.
7. **REDACTED COMMERCIALY SENSITIVE**
8. **REDACTED COMMERCIALY SENSITIVE**
9. As the Board is aware, in addition to the feedback mentioned above in relation to TPMA, CRL has encountered some challenges with a PII supplier following CILEX's public announcement in July 2022. As a master policy would be a fundamental element of the revised offer, CRL cannot take this forward until the future of regulatory arrangements for the CRL regulated community is settled.
10. CRL has made some progress in relation to a case management system linked to CRL's regulatory work. Unfortunately, CRL faces similar issues to those outlined in relation to PII and therefore, at present, CRL has not continued with these discussions.
11. CRL remains confident that there would be a market for this product, which would attract those individuals seeking to become self-employed through a regulated firm, providing

them with confidence and reassurance in relation to the steps they are taking to become a compliant and effective law firm offering services to the public.

12. In conclusion, the proposal remains on hold until the outcome of the investigation and subsequent CILEX actions are known.

Compensation Fund Update

13. As mentioned at paragraph 5, CRL and CILEX agreed to extend the interim compensation arrangements for up to 12 months starting in September 2022, with a review scheduled with CILEX in March 2023. CRL has undertaken a number of activities since September 2022. These are set out below:
 - a. CRL approached again its brokers to determine whether there was a change in market appetite in relation to the availability of insurance for the compensation fund. At present, the market remains hard and although one insurer had expressed some interest earlier in the year, the CILEX announcement has meant, understandably, that the insurer is unwilling to deal with CRL until its future is more certain.
 - b. In December 2022, CRL held a meeting with its regulated firms. At this meeting CRL explained the current position and noted that a key issue was to reduce, as far as possible, the risk posed to consumers in relation to loss of funds. A central discussion related to the possibility of including fidelity guarantee insurance¹ within a firm's PII policy, as well as seeking additional information from the firms in relation to risk mitigation (e.g., outsourcing accounting to a third-party such as the Cashroom).
 - c. CRL has held (and continues to hold) meetings with brokers in relation to the possibility of adding fidelity guarantee insurance into PII policies.
 - d. CRL has issued a questionnaire to its firms in relation to their risk mitigations and so far approximately 50% have responded.
 - e. CRL has a second meeting arranged with firms on 31 January 2023 to provide the firms with an update and seek feedback.
14. An oral update on the position will be provided at the meeting.

Recommendation:

15. The Board is asked to **DISCUSS** the update.

Impact Assessment:

Public/Consumer	
Consumer	The proposal to provide advice, guidance, and support for prospective and new law firms to ensure that they meet all regulatory requirements (and understand why these are important) will enhance the consumer experience.
Public interest	It is in the public interest that all law firms understand and can demonstrate their obligations as a regulated firm offering services to the public.

¹ REDACTED

Access to Justice	Increasing the delivery of legal services to the public via law firms regulated by CRL is likely to have a positive impact on access to justice.
Public Legal Education	No direct impact
Other Regulatory Objectives	
Rule of Law	No direct impact
Competition	A commitment to increasing the number of high-quality law firms delivering legal services to the public should have a positive impact on competition.
Professional principles	No direct impact
Other issues	
Environment	No direct impact
Regulated Community	
Cost of Regulation	Based on CRL's research, there is the potential for the new proposal to deliver services that are of value to prospective law firms. The proposal could ensure that law firms are able to devote their time to the delivery of legal services and minimise the administrative time spent on regulatory actions.
Equality and Diversity	CRL's regulated community is more diverse than some other parts of the legal profession and therefore making positive changes to ensure access to law firm authorisation should have a positive impact on equality and diversity.
Us	
Reputation/Brand	Continued commitment to high standards contributes to maintenance of CRL's reputation
Resources:	The proposals are likely to have additional resource requirements although CRL's research indicates that applicants would be willing to pay a premium for this product.
Operations:	TBC.
Risk:	The central risk to the proposal would be an adverse decision in relation to CRL continuing with independent regulation which would frustrate the benefits outlined above.
Finance:	Additional resources may require additional financial support, however, CRL has not yet completed a detailed cost analysis as it has been impossible to speak with third-party suppliers necessary to progress the proposal at this stage.
Legal:	No direct impact
IT:	There are likely to be additional demands on CRM development, although not required until post-implementation.