

IPReg Compensation Arrangements Rules 2024

These rules set out how *IPReg* will establish and maintain *compensation arrangements* which will need to be applied to the payment by *IPReg* of *discretionary grants*. These grants are made to compensate for losses causing hardship which are suffered as a result of dishonesty by a *registered person* (or former *registered person*) or its *employees* or *managers* (or former *employees* or *managers*). This is to the extent that such losses are not covered by a *registered person's* professional indemnity insurance or otherwise recoverable from another source.

Interpretation – defined terms

1. In these rules, all defined terms set out in italics are as defined in the *IPReg* Glossary unless they are set out in the following table:

Term	Meaning
<i>authorised insurer</i>	<p>a person who:</p> <ul style="list-style-type: none"> (a) has permission under Part 4A of <i>FSMA</i> to effect or carry out contracts of insurance of a relevant class; (b) carries on an insurance market activity, within the meaning of section 316(3) of <i>FSMA</i>; (c) is a European Economic Area authorised body of the kind mentioned in paragraph 5(d) of Schedule 3 to <i>FSMA</i> to effect or carry out contracts of insurance of a relevant class; or (d) does not fall within paragraph (a), (b), or (c) and who may lawfully effect or carry out contracts of insurance of a relevant class in an European Union member state <p>where “relevant class” has the meaning set out in section 87(1B) of the Solicitors Act 1974 and provided that this definition must be read with section 22 of <i>FSMA</i>, any relevant order under that section and Schedule 2 to <i>FSMA</i>.</p>
<i>compensation arrangements</i>	<p>means an insurance policy or a compensation fund under which <i>discretionary grants</i> may be made by <i>IPReg</i> to compensate for losses causing hardship suffered by <i>persons</i> as a result of dishonesty, by a <i>registered person</i> (or former <i>registered person</i>) or its <i>employees</i> or <i>managers</i> (or former <i>employees</i> or <i>managers</i>)</p>

	to the extent that such losses are not covered by professional indemnity insurance or otherwise recoverable from another source.
<i>discretionary grant</i>	means a grant made by <i>IPReg</i> to compensate for losses causing hardship suffered by <i>persons</i> as a result of dishonesty, by a <i>registered person</i> (or former <i>registered person</i>) or its <i>employees</i> or <i>managers</i> (or former <i>employees</i> or <i>managers</i>) to the extent that such losses are not covered by professional indemnity insurance or otherwise recoverable from another source.
<i>FSMA</i>	means the Financial Services and Markets Act 2000.
<i>the Fund</i>	means a compensation fund <i>IPReg</i> has established and <i>prescribed</i> .

Compensation arrangements

2. *IPReg* will establish and maintain *compensation arrangements* which will be applied to the payment of *discretionary grants* it makes. *Compensation arrangements* may take the form of:
 - a. a compensation fund or funds; or
 - b. one or more policies of insurance with an *authorised insurer*.
3. The *compensation arrangements* made under 2 above provide for grants or other payments for the purposes of mitigating losses causing hardship suffered by *persons* as a result of:
 - a. dishonesty on the part of:
 - i. a *registered person* or former *registered person* in connection with their activities as a *registered person*, or
 - ii. a *manager* or *employee* (or former *manager* or *employee*) of a *registered person* or former *registered person* in connection with their activities as a *registered person*.
 - b. fraudulent or dishonest failure on the part of any *person* referred to in sub-paragraph 3a.i. to 3a.ii above to account for money received by them in connection with their activities as a *registered person* or former *registered person*.
4. Every *registered person* must make contributions to the *compensation arrangements*. The rate, amount and payment arrangements for those contributions must be *prescribed*.
5. Any contribution made in accordance with 4 above is recoverable by *IPReg* as a debt due from the relevant *registered person* or former *registered person*.

Management of *the Fund*

6. In the event that the *compensation arrangements* established pursuant to 2 above take the form of *the Fund*, IPReg is responsible for managing **the Fund**. IPReg may:
 - a. hold and distribute any monies raised for the purposes of *the Fund*;
 - b. invest *the Fund* in any investments in which trustees may invest under section 3 of the Trustee Act 2000 (general power of investment);
 - c. insure in relation to *the Fund*, and pay premiums in respect of such insurance from *the Fund*, for such purposes and on such terms as it considers appropriate; and
 - d. borrow for the purposes of *the Fund*, pay interest on any money so borrowed, repay any money so borrowed and use investments which form part of *the Fund* as security for such borrowing.

Discretionary grants and limits

7. IPReg must make any *discretionary grant* in its absolute discretion.
8. IPReg may set out in guidance or in the IPReg Standard Operating Procedure the factors it will consider when exercising its discretion.
9. A *discretionary grant* will not exceed **£30,000 per application granted**.

Eligibility and applications

10. Applications for *discretionary grants* may only be made by:
 - a. an individual *client*, or
 - b. **a company with an annual turnover of £2,000,000 or less which is or was a client**,collectively known as applicants.
11. An application for a *discretionary grant* must be made:
 - a. in such a form as *prescribed*; and
 - b. not more than one year after the applicant first knew, or with reasonable diligence should have known, about the **dishonesty** or failure to account.
12. An applicant must provide evidence **(including any documents or other information that IPReg specifically requests in respect of the application)** to satisfy IPReg that, in consequence of any of the matters referred to in 3 above, they have suffered loss **causing** hardship.
13. IPReg may take into account an applicant's failure to provide documents or other information or failure to co-operate with IPReg when determining the merits of **an application for a**

discretionary grant.

14. If IPReg refuses an application for a *discretionary grant*, whether in whole or in part, IPReg will inform the applicant in writing of its decision and the reasons for that decision within 28 days of the date of the decision. In the event IPReg makes a *discretionary grant*, IPReg will publish its decision to do so, taking into account any confidentiality or other considerations before doing so.

Other remedies and subrogations and decision making considerations

15. IPReg may refuse a *discretionary grant* in respect of all or any part of a loss that is:
- an insured risk; or
 - a risk that would have been insured if professional indemnity insurance had been in place as required by 3.10 of Chapter 2 of the Core Regulatory Framework; or
 - capable of being made good by any other means.
16. Before deciding whether to make a *discretionary grant*, IPReg will require an applicant to:
- pursue any available civil remedy against the *registered person* or *former registered person or employee or manager* (or *former employee or manager*) who is the subject of the application to the extent that it is reasonably practicable to do so;
 - where possible, commence insolvency proceedings against that *registered person* or *former registered person or employee or manager* (or *former employee or manager*) (if they have not already been commenced);
 - make a formal complaint against that *registered person* or *former registered person or employee or manager* (or *former employee or manager*) to the police or other relevant agency; and
 - assist in the taking of any action against that *registered person* or *former registered person or employee or manager* (or *former employee or manager*) to the extent that it is reasonably practicable to do so.
17. If IPReg makes a *discretionary grant*, any rights or remedies of the recipient shall be subrogated to IPReg and, if required by IPReg (whether before or after the making of the grant), the applicant must:
- provide evidence in any insolvency or winding-up of the *registered body* or *former registered body*;
 - sue for recovery of the loss in their name but on behalf of IPReg; and
 - comply with any other reasonable requirement for the purpose of giving effect to IPReg's rights.

Commencement provisions

18. These rules shall apply from 1 May 2024 until further amended or substituted by further rules or regulations.

Supplemental notes

19. These rules are made under section 83A of the *TMA*, section 275A of the *CDPA*, (pursuant to sections 184 and 185 of the *LSA*), an Order made under section 69 of the *LSA*, S.I. 2014 No. 3238, Part 5 of, and Schedule 11 to the *LSA* and section 21 of the *LSA*.

Board Meeting 2 November 2023

Compensation Fund – consultation

Agenda Item: 5

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This paper is for decision.

This Board paper will be published.

Annex A will not be published – confidential advice. A summary will be published with the consultation document.

Annexes B and C will not be published – drafts for consultation.

Summary

1. In October 2021, IPReg established a compensation fund to consider claims from clients (or former clients) who have suffered a loss as a result of fraud or failure to account by a registrant. In agreeing the rule change application to set up the compensation fund (before that, compensation arrangements were provided through an insurance policy) the LSB required a sunset clause. This means that the current arrangements end on 30 April 2024.
2. Our actuary advised us on setting up the fund and undertook a review at one year; he has advised on possible changes to the fund and his latest report is at **Annex A** and he will attend the meeting to present his report and answer questions on it. That report has informed the proposed consultation (**Annex B**) which considers the compensation arrangements from 1 May 2024. Kingsley Napley has redrafted the Compensation Arrangements Rules (**Annex C**) and these will be published with the consultation document.
3. We consider that it is appropriate to adopt the SRA's four guiding principles for its compensation arrangements: viability, stability, manageability and transparency for our compensation arrangements. The proposals set out in this paper have been assessed against these principles and we consider that they are consistent with them.
4. Although no changes to the fund are considered necessary from an actuarial perspective, the consultation proposes the following changes to the current arrangements to increase the level of protection for users of regulated IP legal services:
 - a) Extending eligibility to make a claim on the fund to entities with an annual turnover of less than £2 million (from the current criterion which is based on the definition of micro business).¹ In addition, we would no longer use the criteria that are currently used on balance sheet or number of employees. This would make it consistent with the comparable schemes of the

¹ Having two of: (a) a turnover of £632,000 or less; (b) £316,000 or less on its balance sheet; or (c) 10 employees or fewer.

Solicitors Regulation Authority (SRA) and CILEx Regulation. It also brings it closer into line with one of the eligibility criteria used by the Legal Ombudsman;²

- b) Increasing the limit for an individual claim to £30k (from the current £25k). This would benefit claimants by:
- Helping to preserve the cap’s ‘real’ value to reflect recent high inflation;
 - Taking into account the potential impact of the cost of living increase on any assessment of a claimant’s hardship.
- c) Removing the ability for IPReg to “use the Fund to pay any other costs, charges or expenses incurred by in establishing and administering the Fund”.³ This would mean that the entire fund is available to provide compensation, thus providing more certainty and transparency for consumers about the total amount of compensation available in any one year (i.e. £100k). IPReg’s costs (e.g. actuarial and legal fees) would continue to be taken from our income from practising fees.
5. Actuarial advice is that these changes would not undermine the viability of the fund, are consistent with the guiding principles and could be implemented without the need to increase practising fees.

Recommendation(s)

6. The Board is asked to:
- Discuss and note the actuarial report (**Annex A**); and
 - Agree the consultation for publication (**Annex B**); a draft of the new Compensation Arrangements Rules will be included with the consultation.

Risks and mitigations

	Risk	Mitigation
Financial	<p>Fund is insufficient to meet all claims over the next 12 months.</p> <p>There is an opportunity cost to keeping £100k as a ring-fenced reserve that can only be used to pay eligible claims; it cannot be used to fund other regulatory activities.</p>	<p>The report states that the fund is expected to be viable and meet all claims in full for the next 12 months in all but the most extreme scenarios.</p> <p>If there are no claims then IPReg retains the money in the ring-fenced reserve. Subject to actuarial advice, it may be possible to take out the interest earned and keep the fund at</p>

² Legal Ombudsman [Scheme Rules](#) clause 2.1(a) and (b): A complainant must be one of the following: a) an individual; b) a business or enterprise that was a micro-enterprise (European Union definition [Defined in European Commission Recommendation 2003/361/EC – broadly a business or enterprise with fewer than 10 employees and turnover or assets not exceeding €2 million]) when it referred the complaint to the authorised person;

³ Clause 3.1e of the current [Compensation Arrangements](#)

		£100k. ⁴ This differs from an insurance policy where the premium has to be paid each year even if there are no claims.
Legal	The current rules are not consistent with the new Core Regulatory Framework.	The Compensation Arrangements Rules will be redrafted by Kingsley Napley so that they are consistent with the new Core Regulatory Framework. The redrafted rules will be included in the consultation.
Reputational	A significant number of claims would mean that the fund would be unable to meet all claims. This could damage IPReg's reputation.	The report states that the fund is expected to be viable and meet all claims in full for the next 12 months in all but the most extreme scenarios.
Resources	No specific resource risks. Actuarial and legal drafting resources and costs of £15-20k will be incurred.	We have used the actuary who has previously advised on this matter as he is familiar with our current arrangements and other similar compensation funds. We have instructed Kinglsey Napley as they drafted the regulatory arrangements in the new style.

Background

7. From 2014 (when it was designated as a Licensing Authority) to 2021, IPReg provided compensation arrangements (as defined in the Legal Services Act 2007 s21(2)) by means of an insurance policy with Royal Sun Alliance (RSA). The annual cost of ~£30k was funded through practising fees. In 2021, IPReg was informed that RSA was not going to offer terms for renewal of the policy, due to streamlining its portfolio in the run up to a potential sale. No other insurer was willing to offer a similar policy.
8. Compensation arrangements protect clients who have suffered a loss as a result of fraud or failure to account by a registrant. No claim has ever been made. When the RSA policy was withdrawn, IPReg established a compensation fund. Individual consumers and micro-businesses⁵ are eligible to make a claim on the compensation fund in the event they suffer loss as a result of fraud or failure to account. In agreeing IPReg's proposed rule change to set up the fund, the LSB required a sunset clause to be added; the current arrangements will end on 30 April 2024.
9. Since the 2021 application was made to the LSB, IPReg has increased its evidence base about the type of clients that use regulated IP legal services. In particular, IPReg's work on the Review of our regulatory

⁴ Note that no allowance has been made for investment income (bank interest) or future subrogation recoveries (these are very material for the SRA's fund which last year made grants of c£15m but recovered c£10m). These can therefore provide a 'buffer' for poor claims experience / enable future releases from the fund.

⁵ Micro-entities are very small companies. A company is [a micro-entity](#) if it has any 2 of the following: a turnover of £632,000 or less; £316,000 or less on its balance sheet; 10 employees or less. There were [5.2 million microbusinesses](#) in the UK in 2022, accounting for 95% of all businesses.

arrangements included gathering evidence on specific areas that are relevant to consideration of the design of the compensation fund going forward:

- a. The IP legal services market is largely business to business;
- b. Low levels of client money are held and issues such as mishandling of client money are not common in terms of misconduct or claims on PII;
- c. There are few complaints – the most common reason is complaints about costs information.

10. The Review led to a change in the definition of “client money” to “money held or received by you or your firm in connection with work undertaken for a client, excluding any advance payments for costs received where the terms have been agreed”. This change is likely to result in lower levels of client money being held by regulated firms, with a consequent reduction in the amount of client money at risk from fraud or failure to account.

11. A one-year actuarial interim report (which was considered by the Board in December 2022) found that the fund was expected to be viable for the next 12 months. The current funding/risk model was designed to meet all claims in full until the sunset date in all but the most extreme scenarios. The report found no need to change the total amount of the fund (£100k) or the maximum amount that can be paid for any one claim (£25k). No specific policy alternatives were proposed as a result of the interim review given that there had been no claims and the arrangements could remain until the sunset date of 30 April 2024.

12. This table sets out the previous, current and proposed limits of the fund.

	Previous arrangements (under the insurance policy)	Current arrangements (compensation fund 2021 – 30 April 2024)	Consultation proposals
Individual limit	£22,500 per claim + £2,500 excess ⁶	£25,000 per claimant	£30,000 per claimant
Firm aggregate	£225,000 per practitioner	£100,000 per firm	£100,000 per firm
Total fund	£2.5m	£100,000	£100,000

13. Previous arrangements (under the RSA insurance policy): these applied from 2014 when IPReg was designated as a Licensing Authority (an approved regulator able to license Alternative Business Structures).

14. Current arrangements (compensation fund 2021-now): the RSA insurance policy limit of £25,000 per claim was maintained in the current compensation fund arrangement. This provided a consistent and continuing level of consumer protection and could be implemented without the need to increase

⁶ Under the insurance policy only the excess was payable by IPReg. Under the proposed scheme, IPReg would pay the whole grant from the compensation fund.

practising fees. The maximum level of the fund (£100,000) fund provided both short term viability and the flexibility to run it for the longer term.

15. IPReg proposals for future arrangements from 1 May 2024: the consultation proposes increasing the limit per claim from £25k to £30k; it also proposes extending eligibility to make a claim to firms with up to £2 million turnover; and an amendment to make the entire fund available to pay claims (removing the ability for IPReg to claim costs from the fund; if incurred, these would be paid from practising fees).

Scheme guiding principles

16. We propose adopting the following guiding principles for our policy on compensation arrangements: viability, stability, manageability and transparency.⁷ The following table sets out how our current approach and proposals are consistent with these guiding principles.

Principle	Detail	How met by IPReg Scheme
Viability	Maintain viability of the fund	Scheme initially fully funded (to £100k). Regular actuarial reviews to re-consider balance required for claimant security. Regular review of insurance availability by broker.
Stability	Contributions as manageable as possible	Various 'rating matrices' considered (e.g. by firm turnover, whether client money is held) but these would be overly complex to administer given small annual contribution (c£25k from practising fees)/risk level.
Manageability	Contributions collected in manageable way	Contributions (total £25k), equivalent of c2% of practising fees for most firms. Not cost effective to adapt CRM etc to collect separately.
Transparency	Transparency about fund monies	Separate bank account held. Regular actuarial reviews .

Options and discussion

17. We have considered a number of options for the design of the compensation fund from 1 May 2024.

Do nothing

18. The LSB's [Decision Notice](#) on our 2021 application stated:

- a. *While the changes made by IPReg to its proposals [to expand cover to all micro-businesses, not just in exceptional circumstances] provides some reassurance that there will be a minimum level of cover provided under the scheme, IPReg needs to prioritise its work to ensure a longer-term solution is found that will provide ongoing and sustainable consumer protection for a wider range of consumers of legal services provided by persons authorised by IPReg.⁸*

⁷ These are the same as those adopted by the SRA.

⁸ Decision Notice paragraph 28

19. The actuarial report found that, considering proportionality and materiality, there is no new data to suggest that the current fund model needs revision. However, if we do not make changes to increase the eligibility to make a claim, it is possible that the LSB would refuse the rule change application. In the absence of an extension to the sunset clause, that would mean that there were no compensation arrangements in place. Even if the LSB did not refuse the application, there is a reputational risk to IPReg that would arise from any further criticism by the LSB.
20. Actuarial advice is that eligibility to make a claim can be extended in a way that is consistent with the principles of viability, stability, manageability and transparency. The other proposed changes are also consistent with these principles. None of the proposed changes are expected to lead to an increase in practising fees or a change in the way that the fund is funded (i.e. from practising fees rather than by separate defined contributions from each attorney/firm).

Revert to an insurance policy

21. We approached our broker to get advice on the likelihood of an insurer being willing to provide a policy to provide compensation arrangements. The advice was that the kind of cover that we would need “is not widely bought or sold at the levels we are looking at” and that there is “not [...] much at the likely premium size that will make sense given the frictional costs”. The advice was that we would “need to need to credibly commit to injecting £250-500k or so a year to such a fund, with a view to building up a reinsured fund of say £3m, maybe with only the final £1m of a Fund amount reinsured”. Given that IPReg's annual budget is just over £1m, it does not make sense to pursue this option any further. The actuarial advice agrees with this cost/benefit assessment.

Remove the limit per claim

22. We have considered (with our actuary) whether it would be appropriate to remove completely the limit per claim (up to the limit of the fund). The actuarial advice is that a single claim at £100k could be considered as an extreme scenario, so in theory should be affordable. However, we do not consider that this approach would be transparent. Although it could give the impression of providing increased protection to those eligible to claim because a potential claimant might think that they could receive £100k compensation, IPReg would be very unlikely to agree one single claim that would exhaust the entire fund.

Increase the limit per claim

23. We also considered (with actuarial advice) whether to increase the claim limit from £25k. We considered whether increasing the limit to £50k would be proportionate. As with removing the limit per claim, although this could give the impression that we were increasing consumer protection, it lacks transparency because it seems unlikely that a claim that would significantly deplete the fund in one year would be paid in full. We also took into account data from the SRA's [recent report](#) into its compensation fund which shows that on average the value of successful claims between 2014/15 and 2020/21 was around £23k.⁹ In addition, most successful claims on the SRA compensation fund concern fraud or failure

⁹ The amounts vary from £12k in 2017/18 to £38k in 2020/21. However, our actuary advises us that there are substantial biases in the SRA data. For example, these claim statistics includes £10m from a single firm in 2020/21 and

to account in matters related to probate and conveyancing where very large amounts of client money are held; these activities are not conducted by regulated IPReg attorneys and the amount of client money held is significantly less than the amounts held by solicitors.

24. However, the recent high levels of inflation could have an impact on claimants in terms of the hardship that they face if there has been fraud or failure to account. In addition, the level of inflation means that the current limit of £25k per claim has decreased in value in real terms. The high level of inflation and the cost of living crisis may also increase the likelihood of fraud or failure to account (i.e. there may be an increased risk to consumers). In order to take these factors into account, we consider that increasing the limit per claim to £30k would be proportionate and targeted.
25. Actuarial advice is that this change would not undermine the viability of the fund and could be implemented without the need to increase practising fees.

Extending eligibility to make a claim

26. Under the previous compensation arrangements (i.e. those backed by the insurance policy) individual consumers and micro, small and medium sized enterprises were eligible to make a claim. Under the current rules, only individual consumers and micro-enterprises are eligible because in the first year of the scheme we took a prudent approach. However, this was criticised by the LSB in its Decision Notice. We therefore considered whether it would be appropriate to extend eligibility to make a claim to include firms with up to £2 million annual turnover. In addition, we would no longer use the criteria that are currently used on balance sheet or employees. This would mean that this aspect of the IPReg scheme would be consistent with that of SRA and CILEx Regulation. It also brings it closer into line with one of the eligibility criteria used by the Legal Ombudsman (see footnote 2).
27. We estimate that a significantly higher number of businesses will be eligible to make a claim if eligibility to make a claim is increased to include all firms with a turnover of up to £2m. Using information [published](#) by ONS, we estimate that roughly 287,000 more businesses would be eligible to claim.¹⁰
28. This proposal increases consumer protection and provides more consistency (and less confusion) for consumers across legal services markets. Actuarial advice is that this change would not undermine the viability of the fund and could be implemented without the need to increase practising fees.

the top 3 claims in any year are all £1m+ and skewed towards higher value client money scenarios (e.g. probate and conveyancing). Removing these would reduce average claim to ~£20k. The SRA also note that <50% of claims are successful. Since £20k is the average for successful claims, the actual average per claim actually submitted is more likely to be around £10k.

¹⁰ The methodology to calculate this is: Number of businesses with turnover up to £500k = 2,224,560; Number of businesses with turnover up to £2m = 2,570,560; Based on an assumption that the 222,155 firms between £500k-£1m are linearly distributed, we estimate there would be around 58,649 firms between £500k-£632k. If the increase was from £500k to £2m this would mean an increase in the number of businesses covered of 346,000. However, the current limit on turnover is £632k. Using a rough estimate, increasing eligibility to £2m from the current £632k would increase in the number of businesses covered by: 287,000.

IPReg's costs

29. Under the current compensation scheme rules, IPReg can “use the Fund to pay any other costs, charges or expenses incurred by in establishing and administering the Fund”.¹¹ This is a common feature of this type of fund in the legal sector. To date, IPReg has not used the fund for this purpose – the fund has very low day to day running costs (bank charges and some administrative time) and the cost of actuarial and legal advice has been met from practising fees. We consider that this approach has worked well in practice and the actuary has proposed in his report that to provide certainty about the total amount of compensation that is available in any one year, we propose to remove the ability for IPReg to take its own costs from the fund. We would continue our practice of paying costs from practising fees.
30. Actuarial advice is that this change would not undermine the viability of the fund and could be implemented without the need to increase practising fees.

Other options considered

31. The actuarial review did not consider that it was necessary to change the current **claim limit per firm** (£100k); this is considered sufficient to protect the fund from the failure of a single firm. The actuarial review did not consider that the **limit per year** for claims (£100k) should be changed, noting that the fund is only for dishonesty, is a hardship fund of last resort and that PII which covers negligence is a requirement for all firms and sole traders. The actuary’s report also noted that the fund (£100,000) has been set at a level to meet all claims in full in a reasonable, but not catastrophic (worst case), stress test. This is consistent with both the previous insured Scheme and the interim (self-insured) scheme.
32. The actuary’s report also set out a range of other comprehensive options focused on possible different approaches to funding the compensation fund. These included:
- a. A no claims discount at firm level;
 - b. Allowing firms to pay more for higher limits;
 - c. Lower contributions if no client money is held by the firm;
 - d. Requiring run-off contributions if a firm ceases to trade.
33. All of these options would have required changes to our CRM (which would cost money) and significantly increased the complexity (and therefore cost) of administering the fund. Given that the current (and proposed model) are considered sufficient to meet claims (except in a worst case scenario) and are low cost to administer, the actuary does not consider such changes to the funding model would be proportionate.

Next steps

34. We will publish the consultation as soon as possible after the Board meeting. We will share the consultation with CIPA and CITMA ahead of publication. We anticipate that the consultation will close on 3 January 2024.
35. Kingsley Napley has been asked to redraft the Compensation Arrangements Rules so that they are in keeping with the format of the new Core Regulatory Framework that came into force on 1 July 2023.

¹¹ Rule 3.1(e)

43. We have not been able to identify any specific equality and diversity considerations.

Evidence/data and assumptions

44. The evidence and data used in this paper are set out above.

Board Meeting 18 January 2024

Compensation Fund – consultation and rule change application

Agenda Item: 4

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This paper is for decision.

This Board paper will be published including the Annex (except the yellow shading which indicates redaction).

Summary

1. This paper relates to compensation arrangements to protect clients (or former clients) who have suffered a loss as a result of fraud or failure to account by an IPReg registrant. To increase the level of protection for users of regulated IP legal services, this paper seeks endorsement of the proposed changes to the current compensation arrangements:
 - a) Extending eligibility to make a claim on the compensation fund to entities with an annual turnover of less than £2 million (from the current criterion which is based on the definition of micro business¹ and will no longer use the criteria based on balance sheet or number of employees).
 - b) Increasing the limit for an individual claim to £30k (from the current £25k).
 - c) Removing the ability for IPReg to “use the Fund to pay any other costs, charges or expenses incurred by in establishing and administering the Fund”² meaning that the entire fund is available to provide compensation, providing more certainty and transparency for consumers about the total amount of compensation available in any one year (i.e. £100k).
 - d) Minor changes to the wording of the Compensation Arrangements Rules:
 - ☐ amending “this fund” reference at Clause 6 to “the fund” so that it is consistent with the definition in the Rules;
 - ☐ adding to Clause 15 that we may publish the decision that we make on a claim if there are no confidentiality or other issues in doing so. We would in any event be able to provide high level anonymised information in our Annual Report.
2. Actuarial advice is that these changes would not undermine the viability of the fund, are consistent with the guiding principles adopted by the Board at its [November 2023] meeting (see [paragraph \[10\]](#)) and could be implemented without the need to increase practising fees).
3. Seventeen responses (by 16 respondents – 1 firm provided 2 responses, 1 open and the other closed) to the [compensation arrangements consultation](#) were received. The overwhelming majority of those

¹ Having two of: (a) a turnover of £632,000 or less; (b) £316,000 or less on its balance sheet; or (c) 10 employees or fewer.

² Clause 3.1e of the current [Compensation Arrangements](#)

respondents endorsed these proposals without amendment. A summary table of the consultation responses received is provided as an **Annex**.

4. A rule change application will need to be made to the Legal Services Board (LSB) to take forward these new arrangements which must be in place by 1 May 2024.

Recommendation(s)

5. The Board is asked to:

- Discuss and note the consultation responses summary (**Annex**); and
- Agree for a rule change application to be made to the LSB for new Compensation Arrangements Rules.

Risks and mitigations

	Risk	Mitigation
Financial	<p>Fund is insufficient to meet all claims over the next 12 months.</p> <p>There is an opportunity cost to keeping £100k as a ring-fenced reserve that can only be used to pay eligible claims; it cannot be used to fund other regulatory activities.</p>	<p>The actuarial advice provided to the 2 November 2023 Board meeting stated that the fund is expected to be viable and meet all claims in full for the next 12 months in all but the most extreme scenarios.</p> <p>If there are no claims then IPReg retains the money in the ring-fenced reserve. Subject to actuarial advice, it may be possible to take out the interest earned and keep the fund at £100k.³ This differs from an insurance policy where the premium has to be paid each year and there are no refunds, even if no claims are made.</p>
Legal	<p>The current rules are not consistent with the new Core Regulatory Framework.</p>	<p>The Compensation Arrangements Rules were redrafted by Kingsley Napley so that they are consistent with the new Core Regulatory Framework. The redrafted rules were included in the consultation.</p>
Reputational	<p>A significant number of claims would mean that the fund would be unable to meet all claims. This could damage IPReg's reputation.</p>	<p>The actuarial advice is that the fund is expected to be viable and meet all claims in full for the next 12 months in all but the most extreme scenarios.</p>
Resources	<p>No specific resource risks. Actuarial and legal drafting resources and costs of £15-20k have been/will be incurred.</p>	<p>We used the actuary who has previously advised on this matter as he is familiar with our current arrangements and other similar compensation funds.</p>

³ Note that no allowance has been made for investment income (bank interest) or future subrogation recoveries (these are very material for the SRA's fund which last year made grants of c£15m but recovered c£10m). These can therefore provide a 'buffer' for poor claims experience / enable future releases from the fund.

	We instructed Kinglsey Napley as they drafted the regulatory arrangements in the new style.
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Background

6. From 2014 (when it was designated as a Licensing Authority) to 2021, IPReg provided compensation arrangements (as defined in the Legal Services Act 2007 s21(2)) by means of an insurance policy with Royal Sun Alliance (RSA). The annual cost of ~£30k was funded through practising fees. In 2021, IPReg was informed that RSA was not going to offer terms for renewal of the policy, due to streamlining its portfolio in the run up to a potential sale. No other insurer was willing to offer a similar policy.
7. When the RSA policy was withdrawn, IPReg established a compensation fund to which individual consumers and micro-businesses⁴ are eligible to make a claim on the compensation fund in the event they suffer loss as a result of fraud or failure to account. In agreeing IPReg's proposed rule change to set up the fund, the LSB required a sunset clause to be added, meaning these current arrangements will end on 30 April 2024.
8. No claim has ever been made on our compensation arrangements. Since the 2021 application was made to the LSB, IPReg has increased its evidence base about the type of clients that use regulated IP legal services. In particular, IPReg's work on the review of our regulatory arrangements included gathering evidence on specific areas that are relevant to consideration of the design of the compensation fund going forward:
 - a. The IP legal services market is largely business to business;
 - b. Low levels of client money are held and issues such as mishandling of client money are not common in terms of misconduct or claims on PII;
 - c. There are few complaints – the most common reason is complaints about costs information.
9. The regulatory arrangements review led to a change in the definition of “client money” to “money held or received by you or your firm in connection with work undertaken for a client, excluding any advance payments for costs received where the terms have been agreed”. This change is likely to result in lower levels of client money being held by regulated firms, with a consequent reduction in the amount of client money at risk from fraud or failure to account.

⁴ Micro-entities are very small companies. A company is [a micro-entity](#) if it has any 2 of the following: a turnover of £632,000 or less; £316,000 or less on its balance sheet; 10 employees or less. There were [5.2 million microbusinesses](#) in the UK in 2022, accounting for 95% of all businesses.

Scheme guiding principles

10. We have applied the following guiding principles: viability, stability, manageability and transparency:⁵

Principle	Detail	How met by IPReg Scheme
Viability	Maintain viability of the fund	Scheme initially fully funded (to £100k). Regular actuarial reviews to re-consider balance required for claimant security. Regular review of insurance availability by broker.
Stability	Contributions as manageable as possible	Various ‘rating matrices’ considered (e.g. by firm turnover, whether client money is held) but these would be overly complex to administer given small annual contribution (c£25k from practising fees)/risk level.
Manageability	Contributions collected in manageable way	Contributions (total £25k), equivalent of c2% of practising fees for most firms. Not cost effective to adapt CRM etc to collect separately.
Transparency	Transparency about fund monies	Separate bank account held. Regular actuarial reviews .

Options previously considered

11. We considered a number of options - provided in the [2 November 2023 Board paper](#) - for the future design of the compensation fund which were determined not to be appropriate or proportionate:

- a) *Do nothing*:- whilst the actuarial report found that, considering proportionality and materiality, there is no new data to suggest that the current fund model needs revision, ie. with this option there is a reputational risk to IPReg that would arise from any LSB criticism or refusal of such a ‘no changes’ application.
- b) *Revert to an insurance policy*:- broker advice was that we would need to credibly commit to injecting £250-500k or so a year to such a fund, which would not make sense given IPReg's annual budget is just over £1m. The actuarial advice agreed with this cost/benefit assessment.
- c) *Remove the limit per claim*: - actuarial advice to consider a single claim at £100k as an extreme scenario, was not considered a transparent or stable approach as IPReg would be very unlikely to agree one single claim that would exhaust the entire fund, with the consequent immediate need to replenish the fund ie this would not meet the “Stability” objective.
- d) *Changing the limit per firm, or total per year for claims, both being £100k*:- the actuarial report considered the £100k limit per firm sufficient to protect the fund from the failure of a single firm and given the fund is only for dishonesty, is a hardship fund of last resort and that Professional Indemnity Insurance which covers negligence is a requirement for all firms and sole traders. The actuary’s

⁵ These are the same as those adopted by the SRA.

report also noted that the fund (£100,000) has been set at a level to meet all claims in full in a reasonable, but not catastrophic (worst case), stress test. This is consistent with both the previous insured Scheme and the interim (self-insured) scheme.

- e) *Other options set out in the actuary's report which would have required changes to our CRM and significantly increase the complexity (and cost) of administering the fund:-* a no claims discount at firm level; allowing firms to pay more for higher limits; lower contributions if no client money is held by the firm; requiring run-off contributions if a firm ceases to trade. Given that the current (and proposed model) are considered sufficient to meet claims (except in a worst case scenario) and are low cost to administer, the actuary does not consider such changes to the funding model would be proportionate.

Compensation Arrangements Consultation

12. The [consultation](#) was issued on 16 November and closed on 4 January 2024. The consultation paper was shared with CIPA and CITMA before being published and the IP Practice Directors' Group was notified of its publication. We emailed all registrants, IP Inclusive, the IP Federation, our small firms contact and the Legal Services Consumer Panel to notify them of the consultation. Responses were received from the 2 representative bodies, the Chartered Institute of Patent Attorneys (CIPA) and the Chartered Institute of Trade Mark Attorneys (CITMA), 4 firms: [REDACTED], 7 attorneys in private practice, and 3 sole traders. The overwhelming majority of the resources were fully supportive of the proposals made in that consultation. See **Annex** for a summary table of the responses and the IPReg policy position in relation to any suggested amendments. Suggested amendments relate to: a trial period of eligibility being extended to businesses with income of less than £1 million, before extending it to those with less than £2 million; rewording of the Compensation Arrangements Rules; and applying the cost based upon firm size. Each of these are considered in turn within the following section.

Increase the limit per claim from £25k to £30k

13. Consultation proposal: data from the [SRA compensation fund report](#) found a c£23k⁶ average successful claim, with the majority concerning matters in the areas of probate and conveyancing, neither of which IPReg registrants undertake. High levels of inflation could impact potential claimants in terms of the hardship that they face if there has been fraud or failure to account. Additionally, these inflation levels decrease the value of the current £25k per claim limit in real terms, which is why the actuary proposed increasing the limit per claim to £30k. The actuarial advice was that this change would not undermine the viability of the fund and could be implemented without the need to increase practising fees.

14. Consultation feedback: this proposal was backed by all respondents with the exception of one attorney in private practice who was agnostic to it.

⁶ The amounts vary from £12k in 2017/18 to £38k in 2020/21. However, our actuary advises us that there are substantial biases in the SRA data. For example, these claim statistics includes £10m from a single firm in 2020/21 and the top 3 claims in any year are all £1m+ and skewed towards higher value client money scenarios (e.g. probate and conveyancing). Removing these would reduce average claim to ~£20k. The SRA also note that <50% of claims are successful. Since £20k is the average for successful claims, the actual average per claim actually submitted is more likely to be around £10k.

IPReg response: we have not made any changes to this proposal.

Extending eligibility to make a claim

15. Consultation proposal: under the current rules only individual consumers and micro-enterprises are eligible to make a claim. This is because in the first year of the scheme, based on actuarial advice, we took a prudent approach to eligibility. This was criticised by the LSB in its Decision Notice. Therefore, the consultation proposed extending eligibility to include firms with up to £2 million annual turnover and to no longer use the balance sheet or employee criteria. This would make this aspect of the scheme consistent with that of SRA and CILEx Regulation, as well as bring it closer into line with one of the eligibility criteria to make a complaint to the Legal Ombudsman. Using information [published](#) by ONS, we estimate that roughly 287,000 more businesses will be eligible to make a claim on the fund in event of hardship caused by fraud of a firm or attorney registered with IPReg.
16. Consultation feedback: this proposal was backed by the majority of respondents. One attorney in private practice was agnostic to the proposal and another suggested a staged implementation, increasing eligibility in the first instance to businesses of £1 million turnover in the first instance and then, having evaluated the impact, if any, extend to the proposed £2 million turnover criteria.⁷

IPReg response: we do not consider a staged implementation to be necessary. We agree with the importance of monitoring and we have committed, in the event of a claim on the fund, to commission an actuarial review. In addition, there will be actuarial reviews at least every 3 years even if no claims have arisen.

Remove IPReg's ability to use the fund to pay costs, charges or expenses incurred

17. Consultation proposal: a common feature of this type of fund in the legal sector, the current compensation scheme rules enable IPReg to “use the Fund to pay any other costs, charges or expenses incurred by in establishing and administering the Fund”.⁸ IPReg has not used the fund for this purpose and has paid actuarial and legal costs from its general income. To provide certainty about the total amount of compensation that is available in any one year, the consultation proposed removing the ability for IPReg to take its own costs from the fund. We would continue our practice of paying costs from practising fees (which actuarial advice states will not need to be increased due to this change).
18. Consultation feedback: all respondents endorsed this proposal. CITMA comments that there is no indication in the consultation as to how much it would cost IPReg in terms of human resource and financial cost to administer and consider any claims. CITMA noted that the 2024 budget indicates £10,000 for “Actuarial and Legal Costs in respect of Compensation Fund” but stated that it would be useful to know what proportion of this, if any, is projected to be for handling and considering claims.

IPReg response: our view is that given that we are not expecting any claims, there is no need to make specific budget provision. The RSA policy that was in place provided for wider eligibility than these proposals and so there is no increased likelihood of a claim. Actuarial advice is that data relating to ‘Claims Handling Expenses’ (CHE) is not available in the public domain. The CHE of a single claim would vary depending upon the complexity of the claim. The actuary’s experience of other compensation funds

⁷ Another respondent also made a different point about turnover which we have subsequently clarified with them as they had misunderstood the proposal.

⁸ Rule 3.1(e)

is that such claims are relatively straightforward if all information requirements are met. In the event that claim is made to IPReg, it would be reviewed by the Executive team and a decision would be made by the Board (because this would be a novel event for IPReg). In the event of a claim arising from non-UK claimant, we would calculate the GBP value of the claim at the date of the loss, but that should not be an onerous process. The likely cost of considering a claim would therefore not be expected to have a significant impact on our budget.

Other feedback

19. Amendments to Rules: one of the respondents suggested: amending Clause 6, line 2 to “IPReg is responsible for managing the fund” from “IPReg is responsible for managing this fund” so that it would be consistent with the definition provided in Clause 1 which relates to “the fund”. The respondent also suggested adding to Clause 15 that we may publish the decision that we make on a claim if there are no confidentiality or other issues in doing so. CIPA queried whether the new compensation arrangements are limited to entities based in the UK and if so, suggested this should be made clear in the rules.

IPReg response: we agree with the proposed drafting changes. We will consider what information we should provide in the public domain about any claims, perhaps publishing anonymised information in our Annual Report. The eligibility to claim from the compensation fund applies to all clients of IPReg attorneys or firms, up to entities with a turnover of £2 million, irrespective of whether they live in the UK and whether or not the IPReg attorney or firm is located in the UK.

20. Individuals and small firms should provide the majority of contributions to the compensation fund: one sole trader said that larger firms would be able to provide their own compensation and/or that professional indemnity insurance can potentially cover fraud in some limited circumstances. They do not consider that attorneys in industry should be required to contribute. Additionally, they consider that there should be a visible levy applied on practising fees with a bias towards those in individual and small practices and given the absence of claims over the past ten years, this should be rebalanced over time by the contributions from levies and returns to general funds, and rebated to larger firms.

IPReg response: according to the actuarial report the overall funding cost (that is the ‘expected’ annual claims we are funding for, in the absence of any claims for last 10+ years) per attorney is c£7 a year. Actuarial advice is that this is consistent with the claims levels which insurers would have been funding in the previous insured Scheme (despite the Scheme having had no claims at all). We agree with our actuarial advice, that it would be disproportionate to charge each firm/attorney separately because, for a relatively small registrant base, this would not meet the “proportionality” objective. Potential rebates will be considered at each actuarial review. This will be made clear in the rule change application and in the launch of the new rules. It is considered consistent and transparent that clients (including businesses of turnover less than £2 million) of all firms and attorneys regulated by IPReg are eligible to claim compensation from the fund. The actuary’s report included options such as a no claims discount at firm level; allowing firms to pay more for higher limits; lower contributions if no client money is held by the firm; requiring run-off contributions if a firm ceases to trade. The proposed (and current) model is considered sufficient to meet claims (except in a worst case scenario) and is low cost to administer. Therefore the actuary does not consider such changes to the funding model would be proportionate.

These options were highlighted in the 2 November 2023 paper to the IPReg Board. The Board agreed with the actuarial advice that these options were not proportionate and would have incurred costs such as changes to our CRM and would significantly increase the complexity (and cost) of administering the fund.

22. Whether IPReg plans to return to an underwritten insurance policy: CITMA commented that it would be helpful to understand if IPReg's preferred approach would be to return, at some point, to compensation arrangements whereby an insurance policy is underwritten by an insurance provider rather than a dedicated compensation fund being held by IPReg.

IPReg response: as mentioned in the consultation, in 2021, IPReg's insurance broker was not able to find another insurer willing to provide a similar policy and this continues to be the case.

Rule change application

23. A rule change application will need to be made to the LSB in order to apply the new regulatory arrangements. It is intended that this will be made towards the end of January/beginning of February. As informed by the consultation feedback, the rule change application will cover:

- a) Extending eligibility to make a claim on the compensation fund to entities with an annual turnover of less than £2 million (from the current criterion which is based on the definition of micro business⁹ and will no longer use the criteria based on balance sheet or number of employees).
- b) Increasing the limit for an individual claim to £30k (from the current £25k).
- c) Removing the ability for IPReg to "use the Fund to pay any other costs, charges or expenses incurred by in establishing and administering the Fund"¹⁰ meaning that the entire fund is available to provide compensation, providing more certainty and transparency for consumers about the total amount of compensation available in any one year (i.e. £100k).
- d) Minor changes to the wording of the Compensation Arrangements Rules, amending the "this fund" reference at Clause 6 to "the fund" so consistent with its definition within those Rules and adding to Clause 15 that which we may publish the decision that we make on a claim if there are no confidentiality or other issues in doing so. We would in any event be able to provide high level anonymised information in our Annual Report.

Next steps

24. A summary of the consultation feedback will be published underneath the [consultation paper](#). Both will be included in the rule change application to be made to the LSB.

⁹ Having two of: (a) a turnover of £632,000 or less; (b) £316,000 or less on its balance sheet; or (c) 10 employees or fewer.

¹⁰ Clause 3.1e of the current [Compensation Arrangements](#)

Supporting information

Links to strategy and business plan

25. Reviewing the compensation arrangements has been a key area of our work programme. The current compensation arrangements will end on 30 April 2024, in keeping with the sunset clause timeframe agreed with the LSB. This paper covers what the arrangements will be after this period.

Supporting the regulatory objectives and best regulatory practice

26. This work supports the regulatory objectives of protecting and promoting the interests of consumers; the compensation fund provides recourse for consumers who have suffered loss as a result of fraud or failure to account. It also supports the regulatory objective of protecting and promoting the public interest because targeted and proportionate compensation arrangements provide confidence in the legal services provided by regulated attorneys.

Impacts

27. There are no specific impacts that we can identify on any group of attorneys because we propose to keep the system whereby the compensation fund is financed from practising fees (and do not envisage increasing the practising fees for this purpose).

28. We estimate that a significantly higher number of businesses will be eligible to make a claim if eligibility to make a claim is increased to include all firms with a turnover of up to £2m. Using information [published](#) by ONS, we estimate that roughly 287,000 more businesses would be eligible to claim.¹¹

29. To the extent that eligibility to make a claim will be increased to include firms with a turnover of up to £2m, this may give confidence to those running small businesses who need IP legal advice. The most recent [data published](#) on the Gov.uk website shows that in 2021, 6.1% of small and medium enterprise (SME) employers were led by a majority of people from an ethnic minority (excluding white minorities). The BEIS [small business survey](#) showed that in 2021, 19% of SME¹² employers were led by women (meaning that they were either led by one woman or by a management team of which a majority are women). Women-led SMEs with no employees accounted for 20% of all SMEs with no employees in 2021.

Communication and engagement

30. We shared the consultation with CIPA and CITMA before publication, having already notified the IP Practice Directors' Group that the consultation will be published around mid-November. We emailed all registrants, IP Inclusive, the IP Federation, our small firms contact and the Legal Services Consumer Panel to notify them of the consultation.

31. We will inform CIPA and CITMA of the rule change application on the day it is made. The LSB will publish the application. Whilst that application will include the full actuarial report (the actuary has granted permission for this), we will advise that this is shared on a confidential basis and is not for publication. Upon the LSB's determination of the rule change application we will inform CIPA and CITMA and consequently we will email all registrants to notify them.

¹¹ Please see footnote 10

¹² Those employing 0 – 249 people.

Equality and diversity

32. We have not been able to identify any specific equality and diversity considerations.

Evidence/data and assumptions

33. The evidence and data used in this paper are set out above and in the related [2 November 2023 Board meeting papers](#).

Switching between approved regulators protocol: (switching protocol between the SRA and IPReg)

Introduction

1. The parties to this switching protocol are the SRA and IPReg. This protocol sits under the overarching Framework Memorandum of Understanding (FMOU) signed by the approved regulators and other professional regulators and under the bilateral MOU between the parties. Its purpose is to specifically deal with switching arrangements from one party to the other.

2. For the purposes of this switching protocol the term 'approved regulator' is used to mean either approved regulator or licensing authority.

3. This switching protocol mirrors the terms of paragraph 3 of the FMOU and does not create any legal or procedural rights, prevent compliance with the law, fetter or restrict discretion of the parties nor create any legitimate expectations on the part of the parties to it.

4. Consumer protection arrangements including requirements for the level and scope of professional indemnity insurance ("indemnity arrangements") can be put in place by approved regulators to provide financial protection to clients of firms. These protections are overseen by the Legal Services Board.

5. The Legal Services Board has previously reviewed switching arrangements across the approved regulators. The review acknowledged that switching arrangements between regulators do not present a material risk to consumers. The findings indicated that while the level of switching remained low, the data on this was captured in an inconsistent manner. It also identified a need for greater assurance about the information sharing between regulators during the authorisation processes.

6. For the purposes of this switching protocol, a switch includes a switch of part of a firm, where that part is a successor practice (in whole or in part) of the liabilities of the firm.

7. The aim of this switching protocol is to:

a. confirm the parties' responsibility for a firm's regulation and its indemnity arrangements once a firm switches regulator

b. provide a framework to facilitate the switching between the parties, including the sharing of lawful information in support of the protection of consumers

c. support the parties in keeping consumers informed about who regulates which individuals and firms.

Protecting the financial interests of consumers

8. This protocol recognises that:

a. absolute protection is not achievable at reasonable cost and this is ultimately reflected in the cost of legal services to the public

b. indemnity arrangements differ across the approved regulators.

Responsibility for indemnity arrangements

9. Consumer protection provided by indemnity arrangements is the responsibility of the regulator authorising a firm.

10. It is the responsibility of the receiving regulator to assess all relevant risks to consumers should the switch take place and to make such enquiries as it thinks fit to satisfy itself that it can be a suitable regulator of the firm seeking to switch.

11. The receiving regulator becomes 'the regulator' upon its authorisation of the firm and from that date is solely responsible for the indemnity arrangements of the firm including for historic work.

12. The receiving regulator will decide if it is necessary for the firm to take steps, as the regulator thinks fit, to notify clients of any changes to their protection.

Responsibility for compensation arrangements

13. Consumer protection provided by compensation arrangements will be dealt with under the appropriate rules of each regulator. For the avoidance of doubt, where the circumstances giving rise to a claim under compensation arrangements arose during periods of regulation by both regulators, the parties agree that an individual might be able to claim under both arrangements, provided they had a claim within the scope of the rules of each scheme.

Handling of compensation claims between regulators

14. Issues and problems that arise between the parties will be resolved on the basis of paragraph 26 of the bilateral MOU (as may be amended from time to time).

Sharing information

15. Where it is lawful, the parties agree to disclose information to enable the receiving regulator to evaluate the level of consumer protection it will need to have in place following the proposed switch.

16. Where information is shared it is shared in accordance with paragraphs 14 to 18 of the bilateral MOU.

Keeping consumers informed

17. Each party agrees to take, or to require the switching firm to take, whatever steps it considers reasonable to make sure consumers are informed so they understand:

- a) who regulates relevant individuals and firms
- b) the protections afforded in each case
- c) where and how redress may be sought.

Disciplinary action

18. Where a firm which intends to switch regulator is, at that time, subject to investigation or disciplinary action, the parties will co-operate with each other regarding the authorisation of the firm, to (amongst other things) prevent the firm or individuals evading regulatory action, by switching regulator.

Signatories:

On behalf of the SRA

Andrew Turton..... 

Director of Risk and Information Governance

Dated: 9 May 2023

On behalf of IPReg

Fran Gillon..... 

Chief Executive Officer

Dated: 19 May 2023

Explanations

Approved regulators are designated under Part 1 of Schedule 4 of the LSA 2007 in respect of reserved legal activities as specified in the Schedule. Approved regulators authorise individuals to carry on any reserved legal activity in respect of which it is a relevant' approved regulator. Approved regulators also regulate traditional entities (firms delivering only legal services) pursuant to the LSA 2007 and other legislation applicable to each regulator. In most cases where the Approved Regulator is also the representative body, regulatory functions are delegated to front line regulators.

Licensing authorities are permitted under the LSA 2007 to license entities known as licensed bodies which can provide reserved legal services alongside non-reserved and non-legal services. An approved regulator may be designated as a licensing authority under Part 1 of Schedule 10 of the LSA 2007 in respect of its approved reserved legal activities. Individuals are regulated personally by their own professional regulator but may be involved in an entity which itself is regulated by a different regulator being either a licensing authority or an approved regulator. In these cases, such an individual may also be regulated by the entity regulator.

IPReg

Consultation Paper

Issued 16 November 2023

Changes to compensation arrangements

This consultation closes at noon on 4 January 2024

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Introduction and background

About this consultation

1. IPReg is consulting on changes to its compensation arrangements. These are the arrangements under which grants may be made to consumers and businesses to compensate for loss causing hardship as a result of dishonesty or failure to account by an IPReg-regulated firm or sole practitioner. Compensation arrangements are distinct from Professional Indemnity Insurance (PII). PII covers the cost of compensating clients for loss or damage resulting from negligence. Compensation arrangements apply to the extent that losses are not covered by PII or are otherwise recoverable from another source.

Why are we doing this?

Statutory and regulatory requirements

2. The Legal Services Act 2007 (LSA) defines “compensation arrangements” as:

arrangements to provide for grants or other payments for the purposes of relieving or mitigating losses or hardship suffered by persons in consequence of:

(a) negligence or fraud or other dishonesty on the part of any persons whom the body has authorised to carry on activities which constitute a reserved legal activity, or of employees of theirs, in connection with their activities as such authorised persons; and

(b) failure, on the part of regulated persons, to account for money received by them in connection with their activities as such regulated persons.¹

3. IPReg-regulated firms and sole practitioners must have a PII policy in place. PII covers the cost of compensating clients for loss or damage resulting from negligent services or advice provided by a business or an individual.

Background

4. From 2014 until 2021, IPReg’s compensation arrangements were provided by an insurance policy underwritten by Royal Sun Alliance (RSA). The annual premium for the policy was ~£25k + Insurance Premium Tax and was paid from practising fees (a broker’s fee was also payable). No claim was ever made under that policy. In 2021, RSA notified IPReg that it would not be renewing the policy. IPReg’s insurance broker was not able to find another insurer willing to provide a similar policy and this continues to be the case.
5. Following actuarial advice and consultation, IPReg set up a compensation fund of £100,000 to replace the insurance policy. This is funded from practising fees. In approving the change, the Legal Services Board required a sunset clause and the current arrangements will end on 30 April 2024. In order to ensure continuing consumer

¹ LSA s21(2)

protection we are therefore consulting on new arrangements that will come into force from 1 May 2024.

IPReg's guiding principles

6. IPReg has adopted four guiding principles against which to assess its compensation arrangements and any proposed changes to them. These are: viability, stability, manageability and transparency.²

Claims history

7. No claims have been made on the fund in the 2 years it has been in place. IPReg has not received notification of any likely claims on the fund. There were no claims previously on the insurance policy (which was in place from 2014-2021). This makes a total of 10 consecutive claim-free years.³

Proposed changes

8. Based on the actuarial advice we have received, IPReg is proposing the following changes to its compensation arrangements to improve the level of protection for users of regulated IP legal services:

Extending eligibility to make a claim

9. Extending eligibility to make a claim on the fund to entities with an annual turnover of less than £2 million (from the current criterion which is based on the definition of micro business).⁴ In addition, we would no longer use the criteria that are currently used on balance sheet or number of employees. This increases the number of small businesses that are eligible to make a claim, thereby increasing the level of consumer protection generally for users of IP legal services who are predominantly business to business. It would also make the IPReg eligibility criteria more consistent with the comparable schemes of the Solicitors Regulation Authority (SRA) and CILEx Regulation which also limit claims to businesses with an annual turnover of up to £2m. In addition, it brings the IPReg scheme closer to one of the eligibility criteria used by the Legal Ombudsman for making a complaint.⁵ The proposed changes take into account the comments made by the LSB in its determination of our interim arrangements.⁶

² These are the same as those used by the SRA.

³ For comparison, the SRA had 10,000+ claims to its compensation fund in the same period, of which fewer than 50% led to a payout.

⁴ Having two of: (a) a turnover of £632,000 or less; (b) £316,000 or less on its balance sheet; or (c) 10 employees or fewer.

⁵ Legal Ombudsman [Scheme Rules](#) clause 2.1(a) and (b): A complainant must be one of the following: a) an individual; b) a business or enterprise that was a micro-enterprise (European Union definition [Defined in European Commission Recommendation 2003/361/EC – broadly a business or enterprise with fewer than 10 employees and turnover or assets not exceeding €2 million]) when it referred the complaint to the authorised person;

⁶ [LSB Decision Notice 29 October 2021 \(legalservicesboard.org.uk\)](#)

10. This proposal increases consumer protection and provides more consistency (and less confusion) for consumers across legal services markets. Actuarial advice is that this change would not undermine the viability of the fund (because the original funding model was prudent and was based on the insured Scheme (which covered SMEs)) and could be implemented without the need to increase practising fees.

Consultation Question 1 - What are your views on the proposal to extend eligibility to all businesses with an annual turnover of less than £2m? It would be very helpful if you could provide information on a confidential basis about whether you have clients who would benefit from this change and, if so, how many.

Increasing the limit per claim

11. There have never been any claims on IPReg's compensation policy or fund and we therefore have no claims data to use in our modelling. Instead, we looked at account data from the SRA's [recent report](#) into its own compensation fund. This shows that on average the value of successful claims made between 2014/15 and 2020/21 was around £23,000 a year.⁷ This broadly equates to 1 claim made per 100 solicitors per year. If IPReg attorneys had a similar level of risk with reflective claims on the IPReg compensation fund, that would mean around 35 claims per year, based upon the number of attorneys that IPReg regulates. However, the level of risk is not the same:- most successful claims on the SRA compensation fund concern fraud or failure to account in matters related to probate and conveyancing where very large amounts of client money are held; these activities are not conducted by regulated IPReg attorneys and the amount of client money held is significantly less than the amounts held by solicitors.
12. We propose to increase the limit per individual claim to from £25,000 to £30,000. We consider that this change would benefit claimants because:
- a. The recent high levels of inflation could have an impact on claimants in terms of the hardship that they face if there has been fraud or failure to account;
 - b. The level of inflation means that the current limit of £25,000 per claim has decreased in value in real terms.
13. This proposal increases consumer protection by taking into account the potential impact of the cost of living crisis and inflation. Actuarial advice is that this change would not

⁷ The amounts vary from £12,000 in 2017/18 to £38,000 in 2020/21. However, our actuary advises us that there are substantial biases in the SRA data. For example, these claim statistics includes £10m from a single firm in 2020/21 and the top 3 claims in any year are all £1m+ and skewed towards higher value client money scenarios (e.g. probate and conveyancing). Removing these would reduce average claim to ~£20k. The SRA also note that <50% of claims are successful. Since £20k is the average for successful claims, the actual average per claim actually submitted is more likely to be around £10k.

undermine the viability of the fund and could be implemented without the need to increase practising fees.

Consultation Question 2 - What are your views on the proposal to increase the limit per individual claim to from £25,000 to £30,000?

Removing the ability for IPReg to use the fund to pay its costs

14. We are proposing to remove the ability for IPReg to “use the Fund to pay any other costs, charges or expenses incurred by in establishing and administering the Fund”.⁸ This is a common feature of this type of fund in the legal sector. To date, IPReg has not used the fund for this purpose – the fund has very low day to day running costs (bank charges and some administrative time) and the cost of actuarial and legal advice has been met from practising fees. We consider that this approach has worked well in practice and, to provide certainty and transparency about the total amount of compensation for hardship caused by fraud or failure to account that is available in any one year. We would continue our practice of paying costs from practising fees.
15. Actuarial advice is that this change would not undermine the viability of the fund and could be implemented without the need to increase practising fees.

What are your views on the proposal to remove the ability for IPReg to use the compensation fund to pay its costs?

Consultation Question 3 - What will be the impact of these changes on eligibility to make a claim?

16. We estimate that a significantly higher number of businesses will be eligible to make a claim if eligibility to make a claim is increased to include all firms with a turnover of up to £2m. Using information [published](#) by ONS, we estimate that roughly 287,000 more businesses would be eligible to claim.⁹

What will be the equality, diversity and inclusion impact of these changes?

17. We expect that the proposed changes will have a positive impact on the users of IP legal services. If eligibility to make a claim is increased to include firms with a turnover of up

⁸ Clause 3.1e of the current [Compensation Arrangements](#)

⁹ The methodology to calculate this is: Number of businesses with turnover up to £500k = 2,224,560; Number of businesses with turnover up to £2m = 2,570,560; Based on an assumption that the 222,155 firms between £500k-£1m are linearly distributed, we estimate there would be around 58,649 firms between £500k-£632k. If the increase was from £500k to £2m this would mean an increase in the number of businesses covered of 346,000. However, the current limit on turnover is £632k. Using a rough estimate, increasing eligibility to £2m from the current £632k would increase in the number of businesses covered by: 287,000.

to £2m, this may give increased confidence to those running small businesses who need IP legal advice. Broadening the coverage of the fund will increase the number of businesses that are eligible to claim by around 287,000; this could have a positive EDI impact. The most recent [data published](#) on the Gov.uk website shows that in 2021, 6.1% of small and medium enterprise (SME) employers were led by a majority of people from an ethnic minority (excluding white minorities). The BEIS [small business survey](#) showed that in 2021, 19% of SME¹⁰ employers were led by women (meaning that they were either led by one woman or by a management team of which a majority are women). Women-led SMEs with no employees accounted for 20% of all SMEs with no employees in 2021.

Consultation Question 4 - do you have any data or other evidence about the likely impact of the proposed changes on users of IP legal services, particularly businesses? Do you have any data or other evidence about the likely impact of the proposed changes on equality, diversity and inclusivity?

How will any changes be implemented?

18. Once we have considered the responses to the consultation, the IPReg Board will decide what changes should be implemented and we will make a rule change application to the Legal Services Board. The proposals in this consultation document have been incorporated into new Compensation Arrangements Rules in the style of the new Core Regulatory Framework. These are at **Annex A**. The changes can only come into effect if they are approved by the Legal Services Board.

Do you have any comments on the drafting of the new Compensation Arrangements Rules?

Actuarial advice

19. IPReg has obtained an expert actuarial report on the review of our compensation arrangements. The Executive Summary of the report is at **Annex B**.

20. An assessment of the proposals in this consultation against the guiding principles of viability, stability, manageability and transparency is set out below:

Principle	Detail	How met by IPReg Scheme
Viability	Maintain viability of the fund	Scheme initially fully funded (to £100k), this is proportionate to the specialist profession(s) and activities regulated by IPReg. The fund stands consistently at £100k. Regular actuarial reviews to re-consider balance required for claimant security. In the event of a claim, an actuarial review will be undertaken. Regular review of insurance availability by broker.

¹⁰ Those employing 0 – 249 people.

Stability	Contributions as manageable as possible	Contributions will continue to be made through practising fees, equivalent to around 2% of the total fees paid for most firms. Nothing other than claims can deplete the fund (IPReg will no longer be able to potentially indemnify itself through the fund). The fund is fully funded for the worst case scenario in any particular year. The fund is a fund of last resort where hardship can be demonstrated.
Manageability	Contributions collected in manageable way	Contributions (total £25k), equivalent of c2% of practising fees for most firms. Not cost effective to adapt CRM etc to collect separately.
Transparency	Transparency about fund monies	Separate bank account held. Regular actuarial review (s)

21. The following table shows the key compensation scheme design elements over time and includes the proposals set out in this paper:

Limit	Pre-2021 (insurance policy scheme)	2021: interim (self-insured fund) scheme	2024 onwards: long-term (self-insured fund) scheme
Per claim	£25k	£25k	£30k
Per firm	£225k	£100k	£100k
Per Year	£2.5m		
Eligibility	Current and former individual client; micro, small and medium sized enterprises	Current or former individual client, a micro entity who is or was a client	Current or former individual client, firms of up to £2 million turnover who is or was a client
Indemnity to IPReg included (Rule 3.1(e))	Yes	Yes	No
Prudent Funding Rate	£35k pa (insurance premium)	£25k pa	£25k pa
Extreme Events/ Security for Claimants	Solvency II Standards <i>(insurers can afford a 1/200 year event =</i> <i>“all but the most extreme scenarios”</i>	<i>Fully funded in “all but the most extreme scenarios”</i>	<i>Fully funded in “all but the most extreme scenarios”</i>

Consultation questions

Consultation Question 1. What are your views on the proposal to extend eligibility to all businesses with an annual turnover of less than £2m? It would be very helpful if you could provide information on a confidential basis about whether you have clients who would benefit from this change and, if so, how many.

Consultation Question 2. What are your views on the proposal to increase the limit per individual claim to from £25,000 to £30,000?

Consultation Question 3. What are your views on the proposal to remove the ability for IPReg to use the compensation fund to pay its costs?

Consultation Question 4. Do you have any data or other evidence about the likely impact of the proposed changes on users of IP legal services, particularly businesses? Do you have any data or other evidence about the likely impact of the proposed changes on equality, diversity and inclusivity?

Consultation Question 5. Do you have any comments on the drafting of the new Compensation Arrangements Rules?

Consultation Question 6. Are there any other matters that you would like to bring to our attention?

22. This consultation closes at noon on 4 January 2024. Please send your response to: info@ipreg.org.uk **If any part of your response is confidential, please make that clear.**

Annex F – Responses to Compensation Arrangements Consultation

Respondent	Feedback	IPReg Proposed Policy Position (where stakeholder has proposed amendment)
<i>Representative bodies</i>		
Chartered Institute of Patent Attorneys	<p>Support the proposals.</p> <p>CIPA understands the rationale for extending the compensation scheme’s eligibility to all businesses with an annual turnover of less than £2 million. We are unable to comment on the extent or number of clients of patent attorney firms who would benefit from this change.</p> <p>Increasing the limit per individual claim from £25,000 to £30,000 seems reasonable given the SRA benchmarking data and IPReg’s assessment of the lower risk profile of patent and trade mark attorney firms.</p> <p>As stated in the consultation document, the proposed changes increase the number of entities eligible to make a claim. We are unable to comment on the likelihood of business falling within the new criteria making a claim under the compensation arrangements.</p> <p>We do not have any data or other evidence about the likely impact of the proposed changes on users of IP legal services. We do not have any data or other evidence about the likely impact of the proposed changes on equality, diversity and inclusivity.</p>	

	<p>Are the new compensation arrangements limited to entities based in the UK? If so, this should be made clear in the rules.</p>	<p>The eligibility to claim from the compensation fund applies to all clients of IPReg attorneys or firms, up to entities with a turnover of £2 million, irrespective of whether they live in the UK and whether or not the IPReg attorney or firm is located in the UK.</p>
<p>Chartered Institute of Trade Mark Attorneys</p>	<p>Support the proposals.</p> <p>It would appear sensible and proportionate to extend eligibility by increasing the financial threshold to entities with a turnover of £2 million. Alongside this, increasing the limit per individual claim from £25,000 to £30,000 also seems appropriate.</p> <p>Whilst we support the proposals, given the extensions to the arrangements, it is more likely that a claim will be made, although we suspect the numbers would still be very low. There is no indication in the consultation as to how much it would cost IPReg in terms of human resource and financial cost to administer and consider any claims. The 2024 budget indicates £10,000 for “Actuarial and Legal Costs in respect of Compensation Fund”, however it would be useful to know what proportion of this, if any, is projected to be for handling and considering claims.</p> <p>It would also be helpful to understand from IPReg if the preferred approach would be to return, at some point, to compensation arrangements whereby an insurance policy is underwritten by an insurance provider rather than a dedicated compensation fund being held by IPReg.</p>	<p>We are not expecting any claims so there is no specific budget provision. The RSA policy eligibility was wider than these proposals so there is no increased likelihood of a claim.</p> <p>As mentioned in the consultation, in 2021, IPReg’s insurance broker was not able to find another insurer willing to provide a similar policy and this continues to be the case.</p>

	We have no specific comments on the draft compensation arrangement rules.	
<i>Firms registered with IPReg</i>		
Patent and trade mark licensed body	<p>Supports the proposals.</p> <p><u>Comments:</u> agree that the proposed changes would improve the level of protection for users of regulated IP legal services. The proposals would also safeguard the good standing and reputation of entities and individuals regulated by IPReg.</p>	N/A
Patent and trade mark registered body	<p>Supports the proposals.</p> <p><u>Comments:</u> on the condition that practising fees are not increased as indicated.</p>	N/A
Patent and trade mark registered body, as immediately above (open response)	<p>Supports the proposals.</p> <p><u>Comments:</u> We are broadly in favour of the proposal to extend eligibility as set out. The criterion for eligibility will bring more entities into the scope of the scheme which, in our view, will enhance public confidence in the scheme and regulation of the IP profession as a result. The proposed new eligibility criterion would beneficially improve transparency of the scheme by making eligibility determination more straightforward.</p> <p>Provided the increased limit per claim is affordable within the context of the scheme, which according to the actuarial assessment it appears to be, this seems to us to be a positive move we support.</p>	

	<p>We support this proposed change [removing the ability for IPReg to use the compensation fund to pay its costs]. As set out in the consultation document, this provides greater transparency and viability for the scheme. It also promotes IPReg operating economically if the scheme is utilised in future since its costs for doing so will come from its general funds. In our view, it will promote public confidence in the scheme if it is seen to be solely for the benefit of aggrieved entities.</p> <p>The only hard data we have regarding the impact or the likely impact of the proposed changes on users of IP legal services is that we are not aware of any client or potential client ever having enquired about the availability of a compensation fund or the like. As such, it does not appear to be a factor in determining whether clients engage with the IP legal profession nor influence their choice of service provider.</p> <p>We have two minor comments to make on the draft Compensation Arrangement Rules: a. In clause 6, we would suggest the following amendment at line 2: “IPReg is responsible for managing the fund”. As a matter of drafting, referring to “the Fund” is clearer than “this Fund”, given that the definition in Clause 1 is of “the Fund”.</p> <p>Clause 15 is silent on whether any such decision of IPReg is to be published. We would suggest that any such decision should be published at the discretion of IPReg with relevant personal details redacted if it is believed that it would be beneficial to do so, typically for the IP community or for consumers.</p>	<p>For purposes of clarity and consistency, agree with making this amendment to Rules.</p> <p>For purposes of accountability and transparency, agree with making this amendment to Rules.</p>
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Patent and trade mark registered body	Supports the proposals.	N/A
<i>Attorney in private practice</i>		
Patent attorney	Supports the proposals.	N/A
Patent attorney	<p>Supports the proposal to remove the ability for IPReg to claim on fund for costs incurred.</p> <p><u>Comments:</u> agnostic to the proposals to increase eligibility to claim to businesses with an annual turnover of less than £2 million and to increase the claim limit from £25k to £30k.</p>	N/A
Patent attorney	<p><u>Comments:</u> proposes that there is a 1-2 years period whereby the eligibility to claim is extended to businesses with a turnover of less than £1 million, the impact of this is monitored before making further change and increasing to £2 million.</p>	Agree with importance of monitoring and we have committed, in the event of a claim on the fund, to commissioning an actuarial review.
Patent attorney	Supports the proposals.	N/A
Patent and trade mark attorney	Supports the proposals.	N/A
Patent and trade mark attorney	<p>Supports the proposals.</p> <p><u>Comments:</u> the context of the fund never having been used making it no less important is a very good one. A company with a t/o of £2m is not that large, endorse that with inflation it is appropriate to increase it and likewise the limit per claim. If IPReg can afford not to be compensated then having the entire fund available for</p>	N/A

	compensation make perfect sense. Given that it will be a rare occurrence as well.	
Trade mark attorney	Supports the proposals.	N/A
<i>Sole Traders</i>		
Patent attorney	Support the proposals. <u>Comments:</u> a lovely idea, fully support.	N/A
Patent attorney	<p><u>Comments:</u> In fact, insurance does cover such events as fraud or failure to account (assuming it is dishonest) but there is the following exclusion in the minimum terms: 6.1.16 any liability whatsoever of the Insured arising from a dishonest or fraudulent act or omission committed or condoned by the Insured except that no such dishonesty, act or omission will be imputed to (a) any other Insured or (b) a body corporate unless: (a) in the case of a company it was committed or condoned by all the directors of that company; or (b) in the case of Limited Liability Partnership it was committed or condoned by all members of that Limited Liability Partnership.</p> <p>Clearly, in the case of small firms or individual practices, there is the possibility that fraud will not be covered and that potentially in these cases clients might have no recourse to recover their money, except by calling on IPReg's compensation fund. But, in larger firms, while fraud clearly may be perpetrated, it is unlikely that all the directors/members will be party to the fraud and therefore compensation payable by the firm is covered by insurance. Even where it is the case that all directors</p>	<p>According to the actuarial report, the overall funding risk cost per attorney is £7. This is considered proportionate.</p> <p>It is considered consistent and transparent that clients (including businesses of turnover less than £2 million) of all firms and attorneys regulated by IPReg are eligible to claim compensation from the fund.</p> <p>The actuary's report included options such as a no claims discount at firm level; allowing firms to pay more for higher limits; lower contributions if no client money is held by the firm; requiring run-off contributions if a firm ceases to trade. Though given that the proposed (and current) model is considered sufficient to meet claims (except in a worse case scenario) are low cost to administer, the actuary does not consider such</p>

	<p>are aware of the fraud and no insurance exists, in larger firms it is unlikely that there would need to be a call on IPReg's compensation fund because it is unlikely that the firm could not itself pay compensation at the level IPReg proposes (i.e. £30,000). There would have to be multiple claims before any sizeable firm was troubled and, in that case, IPReg's fund would be inadequate in any event. It therefore seems to me that it is not fair on larger firms, who already pay substantial registration fees, not just for their entity, but also for each of their registered practitioners, to contribute significantly to such compensation fund. Nor is it fair for practitioners in industrial practice to fund the fund. The lion's share of the fund should be contributed by individual and small practices although, for the sake of the reputation of the profession, some contribution can and should be made by all practitioners. Furthermore, I think the funding of the fund should be transparent and not just come out of general practicing fees. Instead, it should be a visible levy applied on practicing fees with a bias towards those in individual and small practices.</p> <p>Given the lack of any claims over the past ten years, whilst the fund is presently funded by general monies, the fund should be rebalanced over time by the contributions from levies and returns to general funds, and rebated to larger firms. Whether the fund should grow over time is another matter.</p> <p>Otherwise I think the proposed changes are perfectly acceptable.</p>	<p>changes to the funding model would be proportionate. These options were highlighted in the 2 November 2023 paper to the IPReg Board. The Board agreed with the actuarial advice that these options were not proportionate and would have incurred costs such as changes to our Customer Relationship Model and significantly increased the complexity of administering the fund.</p>
Trade mark attorney	<p>Supports the proposals.</p> <p><u>Comments:</u> I agree with the proposal and, in my previous firm, we had a number of SMEs and start-ups as</p>	N/A

	<p>clients with a turnover of < £2M (approx. 5%). The turnover figure is more relevant than the number of employees which would depend on the sector involved and whether services or products are being provided/supplied.</p> <p>I agree with the proposal [claim limit increase from £25k to £30k] for the reasons outlined in the consultation paper.</p> <p>I believe that these costs [for running and administering the fund] can be met by IPReg and that there would not be any impact on the ability of IPReg to meet its obligations under the Fund. Also, member firms are likely to provide pro bono legal advice to IPReg, if required.</p>	
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