

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.**

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 its *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>	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 its <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>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 its <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*. XXX
 - 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*.
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 this *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 claimant.

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 to satisfy *IPReg* that, in consequence of any of the matters referred to in 3 above, they have suffered loss causing hardship.
- 13. The applicant has the burden of proving that *IPReg* should make a *discretionary grant* and the applicant must provide *IPReg* with any documents or other information that *IPReg* requires in respect of that application.
- 14. *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 a claim.
- 15. 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.

Other remedies and subrogations and decision making considerations

16. *IPReg* may refuse a *discretionary grant* in respect of all or any part of a loss that is:
 - a. an insured risk; or
 - b. 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
 - c. capable of being made good by any other means.

17. Before deciding whether to make a *discretionary grant*, *IPReg* will require an applicant to:
 - a. pursue any available civil remedy against the *registered person* who is the subject of the application to the extent that it is reasonably practicable to do so;
 - b. where possible, commence insolvency proceedings against that *registered person* (if they have not already been commenced);
 - c. make a formal complaint against that *registered person* to the police or other relevant agency; and
 - d. assist in the taking of any action against that *registered person* to the extent that it is reasonably practicable to do so.

18. 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:
 - i. provide evidence in any insolvency or winding-up of the *registered body*;
 - ii. sue for recovery of the loss in their name but on behalf of *IPReg*; and
 - iii. comply with any other reasonable requirement for the purpose of giving effect to *IPReg's* rights.

Commencement provisions

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

Supplemental notes

20. 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*.

Appendix: Overall Opinion Letter

Fran Gillon
Chief Executive
Intellectual Property Regulation Board (IPReg)
20 Little Britain
London EC1A 7DH

Dear Fran

Revised Compensation Scheme: Scheme Design & Funding

Thank you for asking me to provide a public opinion in the above matter for your consultation document.

Scope of Instructions

The scope of my instructions was as follows:

1. Develop new (long-term), affordable Scheme design
2. Improve Initial Risk Model, in line with (any) proposed new scheme design

Work Carried Out

I have reviewed the Scheme Rules, summarised Firm data, published comparator claims data (and Compensation Fund Fee Structures) for similar Schemes and available (historic) insurance premium quotes (and policy wording) for IPREG's previous (insured) Scheme. I have also reviewed recent public reports of a very large potential compensation claim for another legal Regulatory compensation fund, involving substantial client monies. I have independently constructed a financial model of the expected claims experience of different Scheme designs for IPREG based on my experience of similar Schemes and extensive knowledge of insurers' pricing methods.

I understand the following key constraints apply to claims made under both the current and Interim Schemes:

- Key Rule: **grants only made if funds available**
- Key Eligibility: **claimant must have incurred loss, due to attorney dishonesty, no other means of redress, in hardship**

Revised Scheme: Suggested Design

- In the absence of insurance, the Interim Scheme needs to cap claims for claimants and the Fund, suggested design:

• **Per Claim: £30k / Per Firm: £100k / Per Year: £100k (currently: £25k per claim, rest unchanged)**

- Per claim limit increased to £30k to preserve 'real' value of original £25k limit, following recent high inflation
- Eligibility to be increased to include claims from SME clients of the Regulated Firms
- Rule 3.1 (indemnification of IPREG) to be removed, so that all funds available for compensation
- Minimum Viable Fund: £100k (no change)

Significant Uncertainties

In forming my opinion, I have considered significant uncertainties arising from the following particular matters:

- **The Nature of the Fund:** The fund is a 'hardship' fund only / fund of last resort, not a fund for general compensation claims (eg bad advice)
- **IPReg's own claims experience:** No claims to date (c15 years); implied insurer pricing c£5 claims pa [£10 pa total premium] per attorney (i.e. minimal)
- **Comparator data (SRA):**
 - IPReg is 'tiny' compared to comparator data: <2% of SRA solicitors (150,000: IPReg: c3,500, mostly large Firms)
 - IPReg does not carry out high risk (client-money) work: eg P&C (probate & conveyancing)
 - IPReg's existing grant limits are small: SRA max per claim £2m, IPReg (historically): £25k (<1% of SRA limits)
- **IPReg's risk is therefore unique:**
 - Very low exposure (c3500 attorneys pa), mostly in low-risk work (for client money), mostly larger firms
 - Baseline standard to act honestly, serious consequences otherwise: intervention (personal costs)/disciplinary action/removal from register
 - Since IPReg inception (2010): No compensation fund claims, no Firm interventions, no liquidated Firms
 - Very low claim frequency, expected modest claims (unlike P&C: misuse of probate/conveyancing funds more easily causes hardship)
 - Very high barriers for claimant: eg incurred loss, due to dishonesty, no other means of redress, hardship
 - Risk profile/exposures in small schemes can change drastically year-on-year (new large Firms authorised), but very stable registrant portfolio over several years, low 'churn' rate, high (and improving) compliance rate

Overall Opinion

In my opinion, given the significant uncertainties, the Revised Scheme, associated funding, Risk Model and associated Contributions are expected to be viable and meet all claims over the long-term, in all but the most extreme scenarios, meeting the overall current Scheme philosophy at an affordable cost.

The minimum viable Initial Fund (£100k) has been set at a level to meet all claims in full in a reasonable, but not catastrophic (worst case) stress-test. This builds an initial contingency fund, which could be released over time as more data is collected / any claims emerge etc. eg following further actuarial advice. It also:

- is easy to explain (without complex/spurious statistics) as 'a reasonably bad year' (eg 1 major Firm Intervention: multiple claimants)
- is conservative, and consistent with published high-level SRA data, implied insurer pricing and other Regulators' Funds
- meets public perception (public interest/claimant security) that 'fully funded for N max claims'

Yours sincerely

John Birkenhead