



FOIL UPDATE

June 2010

SRA Consultations - Outcomes-focused Regulation and the new draft Handbook

The Solicitors Regulation Authority (SRA) is in the process of transforming itself and the way it handles regulation in preparation for the changes which will be brought about by the Legal Services Act 2007. It will be making an application to the Legal Services Board to become a "designated competent licensing authority" to enable it to licence and regulate ABSs, prior to the introduction of ABSs in October 2011.

Looking at the changes required to prepare itself for the "new legal landscape" the SRA takes the view that:

- The current Code of Conduct is too detailed and prescriptive.
- Its regulatory approach needs to be more "effective, proportionate and targeted".

The SRA will therefore be moving towards a system of Outcomes-focussed Regulation, (OFR) and will be introducing a new Code of Conduct as part of a new Handbook, pulling together all regulatory requirements.

The New Handbook

All regulatory requirements (the Code, Accounts Rules, Licensing Rules etc) will be brought together in one online Handbook. It will be published in April 2011 and implemented on 6 October 2011.

The new Code of Conduct will be set out in four 'layers'. At the top will be ten high level mandatory 'Principles' which will govern all the activities of a firm. Most of these will be familiar from the current Rule 1 with some new principles including obligations to protect client money and assets, to run the business effectively and in accordance with proper governance, and to deal with regulators in an open, timely and co-operative manner. Below the Principles will sit mandatory 'Outcomes'. These are again quite high level. For example in the Client Care section the Outcomes include:

- *you provide services to your client(s) in a manner which protects their interests in that matter, subject to the proper administration of justice;*
- *the standard of service you provide to clients is competent and prompt.*
- *you only enter into fee agreements that are legal, and which you consider to be in the client's best interests*

Below these two mandatory requirements of the Code will sit two non-mandatory layers: 'Indicative Behaviour' and 'Guidance'. 'Indicative Behaviour' will be set out where the SRA has strong views on the sort of behaviour it is looking for. A firm will

not be obliged to apply the 'Indicative Behaviour' but the presumption will be that if the 'Indicative Behaviour' is not present that there is a risk to delivery of the Outcome and the firm will then need to demonstrate that the Outcome has been achieved by alternative means. 'Guidance' is intended to be used as helpful material which will give examples of good practice.

The Handbook is subject to a separate SRA consultation open until 20 August. A further FOIL Update on the issues it raises will be circulated shortly.

Outcomes-focused Regulation

The key words for the SRA in introducing OFR are 'focus' 'flexibility' and 'pro-activity'.

Focus: the SRA wants to focus on the issues which "really matter to consumers and legal service providers". Firms and individuals will be encouraged to tackle risks themselves, leaving the SRA to concentrate on those "who can't, or won't put things right". The aim is for good firms to be left alone to run their businesses with the SRA focusing on higher risk firms: firms with good systems are likely to experience a "less intrusive relationship" with the SRA.

Flexibility: the aim will be to move away from detailed, prescriptive rules to work instead with firms to deliver good standards. In future the SRA will be much more interested in adherence to overarching Principles and Outcomes and much less interested in the methods firms use to achieve them. This will allow firms to decide how to deliver the required Outcomes, using procedures and methods to suit their clients and their requirements. The Code of Conduct will be changed to achieve this, giving guidance on good practice but leaving firms themselves to decide what to do. Detailed rules will still remain in place in some areas such as Accounts, Licensing and Disciplinary Procedure.

Pro-activity: in future firms will have a different relationship with the SRA: the emphasis will be "on proactive engagement throughout the lifetime of a firm". The SRA will expect to receive much more information from firms throughout their life-cycles, from formation through to wind-up. The SRA will aim to have supervisors and investigators who "understand particular firms' business models and know what good risk management and good outcomes for clients look like". The intention is for the SRA to be able to intervene earlier when it identifies risk and potential problems, not waiting until a firm has failed or harm has already been caused to consumers. The financial stability of firms will be under review.

The Risk Centre

'The Risk Centre' is the term the SRA is using for the new process of pulling in data and intelligence and analysing it to reach its decisions. The SRA sees the Risk Centre "at the heart of delivering and coordinating the proactive assessment of risk" which will enable it to decide upon the areas of low and high risk and allocate resources accordingly. The SRA will be pulling in much more information than at present, including more data from firms, complaints and information from consumers, its own intelligence, market research, and details of broader economic and sector developments. The SRA has ambitious aims in understanding and using external factors in its risk assessments:

"Assessment of market and macro-economic risk will set firm and individual risk in context and will help us to assess emerging systematic risks. We will analyse political, economic, social and technological risks as part of this

approach, and use these assessments to build a capacity for scenario mapping and stress testing”.

Authorisation

In line with its overall approach the SRA will adopt a risk-based approach to authorisation. The process will become more rigorous and evidence-based than at present. ABSs will be authorised on an activity basis, which it appears will enable providers to be authorised for particular kinds of legal work, but not necessarily all types. The SRA indicates that over time it may move to authorise non-ABS firms and solicitors on an activity basis. The SRA’s remit on ABSs will extend across reserved and non-reserved legal activities and also non-legal activities, such as property management, which are subject to conditions on the ABS’s licence. There will be risk-based checking of individuals applying for Practising Certificates on an on-going basis including periodic CRB checks. The regulations covering the Authorisation of ABSs are included in the new Handbook.

The Supervisory Approach

“Supervision is the risk-based oversight of the entire regulated community”. One focus will be on the quality assurance of the firm’s own risk management systems, to assess whether the principles are being upheld and the Outcomes delivered. Supervision will be tailored to take into account the risk posed by the firm, the size of the firm and the firm’s approach to risk management. The SRA will also take into account the extent to which the firm is willing to engage with it and put things right. Large, complex firms, including ABSs, are likely to have dedicated supervisory teams assigned to them (permanent relationship management). Some firms may also become subject to intensive supervision for a short period at time of difficulty (temporary relationship management). Firms not subject to either of these regimes will receive visits based on the risk they represent. The SRA is still deciding if it is appropriate to never visit some low-risk firms. The visits will not cover all issues but are likely to focus on particular issues of concern.

The SRA is keen to make it clear that an important aspect of the new regime will be its focus on working with firms to put things right. It understands that firms need to be confident that the SRA is not seeking to ‘catch-out’ good firms trying to do the right thing. It recognises that the regulated community is “not completely happy” with the current SRA regime and that there is “baggage”.

Financial stability

As part of the changes the SRA will be placing more emphasis of the financial stability of firms, with the aim of preventing significant harm to consumers, avoiding pressures which can lead to dishonest behaviour, and reducing the number of interventions which are a very expensive form of regulatory activity. The SRA believes that it needs to be more proactive in this area.

At the moment firms are only required to produce an annual accountants’ report on compliance with the Accounts Rules. In future much more information will be required including:

- business plans at the authorisation stage;
- accountants reports, data on turnover, self-certified reporting on management information from operational firms;

- a requirement that the SRA is notified if the firm undergoes a significant change such as entering into a new market or if a significant proportion of the partners/employees leave;
- a procedure under which further information from the firm will be requested if there are changes to the economy or new legislation which create greater risk for the firm;
- a requirement that a firm notifies the SRA if it requires significant borrowing or if it considers itself 'in distress'.
- A requirement that firms notify the SRA in advance of being wound-up.

Issues

FOIL's Director of Information, Shirley Denyer, attended a workshop at Chancery Lane and a seminar in Manchester on the new proposals. A number of issues were raised at those meetings which give a flavour of the concerns which firms have about the new regime. These can be summarised in three areas:

Excessive intrusion – concern was expressed that the SRA's desire to be pro-active may lead it into areas which are outside a regulator's remit. Some of the circumstances discussed, of the SRA becoming concerned if a firm's business model appears unsustainable or if a firm does not appear to have the right staff to deliver a particular service, led to concerns being raised that SRA officers were in danger of becoming pseudo management consultants, becoming excessively involved in micro-management of firms. Concerns were also expressed that an overly-cautious approach from the SRA might stifle creativity and make it difficult for firms to innovate. The SRA itself acknowledges that there is a balance to be reached in the information it requires from firms, and in the way it identifies and tackles issues it believes could create risk.

Lack of guidance - There is concern that the greater subjectivity in the rules creates more uncertainty. The consultation paper itself notes that the Outcomes within the Code are not an exhaustive list of all possible applications of the Principles. Concerns were expressed at the workshop that at the moment the rules provide a way of resisting pressure from clients – "I am unable to do that because I am not allowed to under the rules". If the rules were much more general it will be more difficult to do that. There was also concern that individuals may come under pressure to interpret the Principles and the Outcomes to suit commercial interests, and the greater flexibility will make it harder to resist that type of pressure. The issue of 'safe harbours' – of getting the SRA to sign off particular decisions on the rules - is being raised around the country at the workshops but the SRA position in the OFR consultation is that it will not be able to do this – obviously there will not be the resources to carry that out and it is not appropriate to run a regulatory regime on that basis. It seems likely that there will be more potential for grey areas - how will firms have the confidence that they are doing the right thing?

The Resources and Skills of the SRA - There was some angry comment from the floor at the Manchester workshop to the effect that the SRA staff are not up to the job as they are not lawyers and have never run a business. Questions were also asked about how the SRA will ensure a consistent approach across the whole organisation. There was anecdotal evidence from the floor that the SRA is slow, asks the wrong questions and will not respond to genuine concern. The SRA sought to reassure that it is recruiting appropriate staff, and that employees are undergoing appraisal and training. The new approach will depend very much upon the SRA working successfully with firms and making the right decisions on risk – is it really up to that job?

The full consultation paper 'Outcomes-focused Regulation' and the draft Handbook is available on the SRA website:

<http://www.sra.org.uk/sra/consultations/OFR-consultation.page>

<http://www.sra.org.uk/sra/consultations/OFR-handbook-May.page>

If you have any comments on the OFR proposals please contact Shirley Denyer on shirley.denyer@foil.org.uk by **2 July** please. The consultation closes on 27 July 2010.

As mentioned above a further Update will be available shortly on the Handbook and there will be a further opportunity to comment on that before the FOIL response is prepared. The Consultation on the Handbook closes on 20 August.

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