



# **Solicitors Regulation Authority: Achieving the right outcomes**

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## What is this paper about?

1. This paper explains how the SRA intends to transform the regulation of solicitors and the organisations in which they work, and invites the engagement of consumer groups, the profession, and all those with an interest in legal services in the debate about how we deliver it.
2. In essence, our approach is to deliver:
  - a. outcomes-focused regulatory requirements<sup>1</sup> designed to give flexibility by avoiding unnecessary prescriptive rules on process, while giving clear guidance on what it is that firms must achieve for their clients;
  - b. an approach to the supervision of firms that helps firms achieve the right outcomes for clients, and that encourages firms to be open and honest in their dealings with us;
  - c. a high quality desk-based research and analysis capacity to assess the potential risks to the regulatory outcomes, supporting and leading the SRA's delivery of evidence-based and risk-based, proportionate regulation;
  - d. enforcement action which is prompt, effective, proportionate and creates a credible deterrent against failure to act in a principled manner.
3. Our approach will not mean the abolition of all detailed rules, nor will it mean a lack of clarity about the circumstances in which firms will be subject to enforcement. Rather, it means a focus:
  1. in the regulatory regime on those requirements which are genuinely needed to protect clients and deliver high standards of service;
  2. of resources on those issues and activities that represent the greatest risk to the regulatory objectives that are now set out in the Legal Services Act.
4. Consumers must be clear about the protections available to them. For this reason, we propose that our new approach should apply to all types of law firm, both traditional law firms and the new types of types of law firm (alternative business structures, or ABSs), which will be introduced from next year. This stance was supported by respondents to our recent consultation on ABS, <http://www.sra.org.uk/sra/consultations/regulating-alternative-business-structures-june-2009.page>.

## Benefits and challenges

5. The Legal Services Act sets out the regulatory objectives for legal services providers and their regulators<sup>2</sup>. It also requires regulators to have regard to the

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<sup>1</sup> See "Our approach to regulatory requirements" below.

<sup>2</sup> See Section 1 Legal Services Act 2007.

principles under which regulatory activities should be: transparent, accountable, proportionate, consistent and targeted (“the better regulation principles”). The SRA believes the approach described in this paper will make regulation more effective and will better achieve these objectives and principles.

6. We also believe that there are considerable benefits both to clients and firms from our approach, including:
  - a. culture—a greater focus within firms and the SRA on quality assurance and professional principles;
  - b. business value vs. cost reduction—our approach will assist firms by giving them flexibility over the manner of compliance, while encouraging them to consider the longer-term value that their business will derive from acting in a principled, client-focused manner;
  - c. flexibility and innovation—over-detailed regulations can constrain firms in terms of their choice of business model and in their manner of compliance; we will, therefore, remove regulatory requirements that cannot be justified on the basis of the better regulation principles; and
  - d. differentiation based on risk—firms’ experience of regulation and supervision will depend on our risk analysis, which will take into account the firms’ own risk-management systems.
7. We recognise that firms will have concerns and will face a number of challenges:
  1. senior managers will need to take greater responsibility for creating the right culture;
  2. the greater flexibility, while providing opportunities for innovation, also presents challenges for firms in determining for themselves the approach to delivering the right outcomes for clients;
  3. new market entrants will want us to manage the balance between an overly detailed Code (which restricts new forms of practice and innovation), and on the other hand a more principles-based approach (which lacks sufficient clarity about the expectations of the regulator).
8. There are significant challenges too for the SRA, not least how to ensure we have the right skills, systems and processes for this regulatory approach and how to monitor and evaluate the transition and measure the success of our approach. We will be better able to meet those challenges by engaging with legal services providers and consumers throughout the process. That will help us to ensure that the transition to our new approach is achieved in the most efficient manner, maintaining client protection. Through this paper we are beginning the process of engagement and need your views on both the approach and how that important engagement should continue. In particular, we need to understand whether, and to what extent, the new approach might have positive or negative impacts for particular firms.

## **(a) Our approach to regulatory requirements**

### Current regulatory regime for solicitors

9. The current structure of the regulatory regime consists principally of:
  - a. the Solicitors' Code of Conduct 2007 (the Code);
  - b. the Solicitors' Accounts Rules 1998 (governing the conduct of solicitors' accounts and, in particular, the handling of client money);
  - c. the SRA Recognised Bodies Regulations 2009 (concerning applications by firms for approval by the SRA as a body suitable to provide legal services); and
  - d. the client financial protections—indemnity insurance and compensation fund requirements.
10. Some examples of how our new approach might alter the regulatory regime and our approach to supervision are set out in Annex 1.
11. We would welcome comments on the approach described in this paper. Contact details are set out at paragraph 33 of this paper.
12. We believe that:
  - a. greater emphasis needs to be given to the professional principles by which firms should conduct their business (currently contained in rule 1 of the Code of Conduct: the core duties) and how they influence the way legal services are delivered. We also believe that these professional principles may need to be expanded to better express the breadth of professional duties of legal services providers;
  - b. we should only have rules when they are necessary (e.g. to ensure client protection); and
  - c. more guidance could be given on the expected outcomes for clients and other third parties of compliance with the professional principles, rather than simply guidance on how to comply with rules.
13. For other elements of the existing regulatory regime—such as those relating to the indemnity fund and the licensing requirements—we believe that it is appropriate to retain "bright-line" rules because of the clarity that they provide for firms and other stakeholders (e.g. insurers). However, where possible, we will be seeking to introduce more flexibility.

### What might the new Code look like?

14. We believe that the introduction of a new Code of Conduct is central to the implementation of the new approach. We have been exploring different models for a new Code and will be undertaking a number of initiatives with current firms and those intending to establish ABSs to discuss the new Code and the practical challenges for firms.

15. We set out below an example of one model in order to show what the new approach might look like. We have made some assumptions on what our new core principles might look like to illustrate the model. The example relates to client relations and can be compared with rule 2. Our intention is to focus on the core principles, while at the same time explaining what type of behaviour would tend to show that a firm was achieving or not achieving the desired outcome and so complying with the core principles.
16. It should be clear from the model that we are not in any sense lowering the standard required from firms, and, therefore, the level of customer protection. On the contrary, by focusing on core principles and outcomes we are encouraging firms to consider how that standard can best be provided to their client base, given their business model. In particular, this allows firms to tailor their approach according to their clients' needs. It should make regulation more effective.
17. The move to this new approach may well lead to the removal of some restrictions as we consider whether particular requirements are necessary for effective regulation.

## Example 1

### **Core principles relating to client relations**

You must act in the best interests of each client; and  
You must provide a good standard of service to your clients.

### **Client Relations**

Core principle 1 states that you must act in the best interests of each client; and  
Core principle 2 states that you must provide a good standard of service to your clients.

Core principle 1 is intended to achieve the following outcomes for your clients:

1. Clients are confident that the firm has the intention, resources, skills, and procedures to act in their best interests.
2. Clients receive services in a manner which at all times protects their interests, subject to the administration of justice.
3. You only accept or refuse instructions and enter into fee arrangements that are permitted by law and accord with the core principles.
4. Clients are protected to the extent of the minimum level of indemnity insurance required by the Solicitors' Indemnity Insurance Rules for a policy of qualifying insurance.
5. Clients are in a position to make an informed decision about limiting your liability above the minimum level of indemnity insurance required by the Solicitors' Indemnity Insurance Rules for a policy of qualifying insurance.

Core principle 2 is intended to achieve the following outcomes:

- The standard of service received by clients is competent and delivered in a timely manner.
- Clients who complain are treated fairly and their complaint is handled in a timely manner.
- Clients are in a position to make informed decisions about the services provided and the options available to them, including costs.

### **Examples**

E1 Undertaking the following would tend to show that you have achieved the outcomes and, therefore, complied with Principles 1 and 2:

#### *Conduct of a client's matter*

- agreeing an appropriate (level) of service with your client;
- explaining to your client your responsibilities and those of the client;
- ensuring that the client is given, in writing, the name and status of the person dealing with the matter and the name of the person responsible for its overall supervision; and
- explaining any limitation or conditions resulting from your relationship with a

third party (for example a funder, fee sharer or introducer), which affect the steps you can take on the client's behalf.

#### *Funding arrangements*

- discussing with the client whether the potential outcomes of any legal case will justify the expense or risk involved including, if relevant, the risk of having to pay an opponent's costs;
- advising the client of the basis and terms of your charges and if and when they are likely to be increased;
- advising the client of likely payments which you or your client may need to make to others;
- discussing with your client how the client will pay and, in particular, whether the client may be eligible and should apply for public funding, and whether the client's own costs are covered by insurance or may be paid by someone else;
- advising the client of their potential liability for any other party's costs and whether these may be covered by alternative means;
- where you are acting for a client under a conditional fee agreement, informing the client of all relevant information relating to that arrangement and the client's liability for fees;
- where you are acting for a publicly funded client, disclosing all relevant information relating to the impact on costs of their publicly funded status; and
- providing the relevant information to the client in a clear form and in writing, except where it is unnecessary to do so.

#### *Complaints handling*

1. having a written complaints procedure;
2. providing each client with relevant information concerning their rights and the firm's approach to complaint handling;
3. informing the client at the outset how complaints can be made and to whom complaints should be addressed;
4. providing the client with a copy of the firm's complaints procedure on request; and
5. in the event that a client makes a complaint, providing them with all necessary information concerning the handling of the complaint.

E 2 Undertaking the following would tend to show that you have not achieved the outcomes and, therefore, not complied with Principles 1 and 2:

#### *Accepting instructions*

1. taking on or retaining a client when you have insufficient resources or lack the competence to deal with the matter;
- taking on a client when instructions are given by someone other than the client, or by only one client on behalf of others in a joint matter without checking that all clients agree with the instructions given;
  - taking on or retaining a client where you have reasonable grounds for believing that the instructions are affected by duress or undue influence without satisfying yourself that they represent the client's wishes;
  - ceasing to act for a client without providing reasonable notice; or
  - entering into a contingency fee agreement before:

- a court of England and Wales, a British court martial or an arbitrator where the seat of the arbitration is in England and Wales, except as permitted by statute or the common law; or
- a court of an overseas jurisdiction or an arbitrator where the seat of the arbitration is overseas, except to the extent that a lawyer of that jurisdiction would be permitted to do so.

**[Additional guidance as required]**

## **(b) Our approach to supervision and enforcement**

### Current supervision and enforcement

18. As stated above, it is important that supervision and enforcement are aligned with the approach to regulatory requirements, in accordance with the better regulation principles which require us to target our resources in accordance with our assessment of risks.
19. The following issues have been identified in relation to the current approach to supervision:
  - a. identification of key risks—we have insufficient management information on firms. This means that we are constrained in the extent to which resources can be accurately targeted at the identification and resolution of high-risk issues;
  - b. oversight of firms —an approach to supervision that has been more focused on identifying detailed rule breaches as an end in itself, rather than assessing the outcome for clients and the public interest and whether any detriment was suffered; and
  - c. guidance to firms—by virtue of the current content of the Code, Ethics Helpline staff can spend a great deal of time advising on detail rather than helping firms to improve their standards and better protect the interests of their clients.
20. The SRA already pursues enforcement cases primarily on the basis of breaches of core duties. Some of the largest fines imposed by the FSA have been for breach of principles. However, while we have made significant shifts in our approach to enforcement (e.g. in the use of regulatory settlement agreements), we could go further to differentiate between those firms that should properly be disciplined and those who should be supported in improving standards. This will allow for different types of supervision for different firms.

## What might the approach to supervision and enforcement look like?

21. The contact between the SRA and the firms it regulates will change, both in terms of the level of contact and the content of that contact. This contact will increasingly focus on gaining an understanding of the firm in order to assess the risks that it poses to the statutory objectives and, in particular, to the public and consumer interests. In visits to firms we will move away from the investigation of rule breaches, to a discussion of whether a firm can demonstrate that it is acting in a principled manner and achieving desired outcomes for clients. In other words, there will be less “ticking of boxes” and more discussion of the effectiveness of the firm’s risk management systems.
22. The basis for enforcement action is likely to change, in that there will be more instances of enforcement based on a breach of principles and a failure to achieve defined outcomes, and fewer based on a failure to comply with detailed rules. We would characterise this change as one of emphasis (i.e. focusing on our primary concern, which is compliance with the core principles).
23. We will continue to review the balance between enforcement actions against legal services providers and individuals. In the case of individuals, the focus will be on senior managers and their approach to the exercise of their responsibilities.
24. We recognise that the primary aims of a regulator are to change behaviours and discourage unprincipled behaviour. Disciplinary action is not always the best way of doing this and we will continue to use and develop options such as Regulatory Settlement Agreements. Where firms show that they are willing to address problems in a responsible manner, disciplinary action should usually be avoided.
25. In making these changes, we are aware that firms and their senior managers will be concerned about the risk of “retrospective regulation”. For this reason, we expect that there will be a need for guidance for firms on the interpretation of our regulatory approach, which should enable firms to know, at the time when they take an action, whether that action should expose them to the prospect of enforcement action because it is a breach of either the principles or the rules. Firms should be in a position to predict what behaviour demonstrates compliance with the core principles.

## Example 2

### **An application for authorisation**

A group of solicitors decide to set up a new firm. The group applies for authorisation and is required to provide information relating to its proposed structure, activities and sources of income. The group is also required to supply the SRA with a five-year business plan to assist the SRA in determining the likely risks to the regulatory objectives and, in particular, to the public and consumer interests.

In the course of reviewing the business plan, we have had discussions with the group of solicitors over matters such as:

- the extent to which the new firm will be reliant on one source of income (a referral arrangement from a trade union);
- the proposed operating structure (one qualified solicitor to twenty non-qualified staff) and how the proposed partners of the new firm will ensure an appropriate standard of advice is given to clients; and
- the previous experience of the proposed partners in the new firm, and in particular, their experience of running a partnership.

## Example 3

### **A visit to a firm to discuss client relations**

We would hold meetings with senior managers to see how they assure themselves that clients are in a position to make informed decisions about the services provided and the options available to them, including costs.

The evidence the senior managers are likely to use would encompass results of internal monitoring of standards based on the firm's own risk assessment, client satisfaction surveys, analysis of client complaints (including complaints referred to the LCS/OLC), results of internal file audits and internal training and outcomes of periodic reviews of standard documentation. They could also include other methods that the firm has developed to suit its own client base/business model.

We would also consider how the firm had responded to issues that it had identified. We would be looking for a commitment to identifying and resolving issues and promoting best practice. Our concern will be to work with the firm to improve standards. Where problems are identified, but the firm is responsive to the need for change, we would look to the firm to set out its own approach in an action plan, which we would monitor. This would be unlikely to lead to disciplinary action.

## Example 4

### **Thematic review**

As a result of changes to the delivery of legal services, our analysis of data received from firms and the outcome of visits to firms, we decide to undertake a review based around the theme of the management by firms of conflicts of interest. The rationale behind the themed review is that our analysis of emerging risks from the changes to the legal services market combined with its analysis to date indicates that, while firms

may have conflicts of interest policies, they are nevertheless acting in cases where they have a conflict of interest.

We take the following action:

- a series of visits of firms identified as representing a “high risk” in relation to conflicts of interests is undertaken to:
  - (i) assess the quality of controls within firms to manage conflicts of interest,
  - (ii) identify instances where clients may have been prejudiced by firms acting where a conflict exists, and
  - (iii) determine what remedial action firms need to undertake and whether disciplinary action is appropriate;
- following the visits, all firms receive additional guidance from the SRA regarding its expectations in relation to the management of conflicts of interest;
- we conduct a series of workshops on conflicts focusing on the expected outcomes for clients of effective conflicts management; and
- we issue a warning to firms that continued failures in relation to conflicts of interest will result in more severe regulatory action.

## Support for firms

26. Our intention is to assist firms with the transition to our approach in the following ways:

- a. formal and informal consultation—we will be conducting a series of workshops with firms to discuss the approach and, in addition, will consult on changes both to the regulatory regime and changes to our approach to supervision and enforcement;
- b. guidance—our intention is to publish guidance both for existing firms and new market entrants on what the transition will mean for them and how they can prepare for it. This guidance will also show where firms’ existing procedures (e.g. terms and conditions and client care letters do not need to change to meet a fixed deadline, unless firms wish to take advantage of new opportunities provided through the more flexible Code of Conduct);
- c. pilots—we will be piloting our approach to supervision and will discuss with firms what we have learned from that exercise. We will learn from successful approaches developed by other regulators.

## Timetable—risks and feasibility

27. Given the risks associated with the move towards our approach, and the need to align the content of regulation with the approach to supervision and enforcement, the timing of the implementation needs to be considered very carefully.
28. Changing both the regulatory requirements and the manner of supervision and enforcement involves significant effort and consultation with (and education of) stakeholders. It is also the case that the legal services market is experiencing change through the opening up of the provision of legal services to legal disciplinary practices (LDPs) and ABSs in the future.
29. We propose that the new Code of Conduct will be brought into force from the date when ABSs are permitted to obtain licences (in the second half of 2011), but will be the subject of extensive consultation in 2010.
30. Changes to supervision and enforcement will be more evolutionary as we are already changing our methods of supervising firms and focusing enforcement on firms, and only on individuals where necessary. We will begin the process of piloting approaches to supervision visits in 2010 with a view to wider implementation of such visits in 2011.
31. We will, of course, continue to adapt our approach to regulation, supervision and enforcement in the light of emerging risks.

## Responses and next steps

32. We would be interested to receive comments on any aspects of this paper. We would be interested in the views of consumers of legal services: both individuals and commercial clients. In particular, we need to understand from the profession how we can help them to respond and adapt to our approach and to identify any risks and issues.
33. We would welcome your views as soon as possible and no later than 6 March 2010. Please send your comments, views or concerns either via email or post to:

Margaret Hope.  
Professional Ethics Unit  
Solicitors Regulation Authority  
Ipsley Court  
Redditch  
Worcs  
B89 0TD

**or**

Margaret Hope  
Professional Ethics Unit  
Solicitors Regulation Authority  
DX 19114 Redditch

**or** [ofr@sra.org.uk](mailto:ofr@sra.org.uk)

Please ensure that you complete and return an "[About you form](#)" (either as an email attachment or by post).

### **Confidentiality**

We may publish a list of respondents with a report on responses. Partial attributed responses may be published.

If you prefer any part or aspect of your response to be treated as confidential, please ensure that you advise us accordingly.

34. We will publish a further consultation on the way we will develop our approach to more effective regulation in March 2010. That will be followed by a significant consultation on draft licensing rules that are required in order for us to become a Licensing Authority for the registration of ABSs. We are committed, as far as possible, to have one set of principles and rules applying in-depth regulations to traditional firms and ABSs. Therefore, this consultation will include drafts of the new principles-based Code of Conduct, discussed in this paper.

## Annex 1

Issue	Current practice	Our new approach
<p><b>Regulatory regime</b></p>	<ul style="list-style-type: none"> <li>•Core duties define professional principles</li> <li>•Focus on “how to comply” less on outcomes</li> <li>•Limited description of “outcomes” to be achieved through compliance with the core duties (rule 1) which can lead to confusion regarding expectations of SRA</li> </ul>	<ul style="list-style-type: none"> <li>•Expanded set of core duties/principles define the essential behaviour expected from firms</li> <li>•Outcomes describe what compliance with the core duties/principles should achieve for clients, third parties, etc. clarifying expectations of the SRA</li> <li>•Removal of rules unless these can be justified</li> <li>•Greater guidance supported by an education programme</li> </ul>
<p><b>Supervision</b></p>	<ul style="list-style-type: none"> <li>•Supervisory visits/investigations focused on rule breaches, which can lead to protracted debate about the materiality of issues identified</li> <li>•Risk assessment based on limited information from firms, which means that the SRA may not always focus its resources on genuinely higher risk firms</li> </ul>	<ul style="list-style-type: none"> <li>•Risk-based system in place for assessing and risk-rating firms to inform supervision</li> <li>•Enhanced management information (MI) received from firms throughout their life-cycle used to inform their risk categorisation on an ongoing basis</li> <li>•Enhanced MI received from firms to support risk assessment</li> <li>•Supervisory resources targeted on high-risk firms/market segments</li> <li>•Management information can be supplied by firms online, reducing paperwork.</li> <li>•Risk assessment process means that there is greater transparency in the SRA's decision-making and supervision activities</li> <li>•Larger/higher-risk firms are relationship-managed by staff with specialist knowledge of their work</li> </ul>

<p><b>Enforcement</b></p>	<ul style="list-style-type: none"> <li>•Spring 2010—firm-based approach to enforcement begins with new disciplinary sanctions</li> <li>•Use of regulatory settlement agreements</li> <li>•Enforcement actions based on breaches of rules and core duties, which can lead to protracted debate over the validity of the enforcement proceedings.</li> </ul>	<ul style="list-style-type: none"> <li>•SDT supports outcomes-based enforcement</li> <li>•Lessons learned from outcomes-based enforcement are used to refine SRA's approach to regulating and supervising firms</li> <li>•SRA publishes more guidance based on its analysis of enforcement cases, enabling firms to understand the SRA's expectations and those behaviours likely to lead to enforcement action</li> </ul>
<p><b>Education</b></p>	<ul style="list-style-type: none"> <li>•Engagement with firms using: <ul style="list-style-type: none"> <li>○ consultation;</li> <li>○ dialogue via The Law Society's special-interest groups; and</li> <li>○ speeches.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>•Closer dialogue with firms and consumer bodies</li> <li>•Greater focus on guidance related to the outcomes firms are expected to receive, rather than the "how" of compliance with individual rules</li> <li>•Obtaining guidance via the Ethics Helpline is facilitated by the new Code. Firms are empowered to decide for themselves the most appropriate way to achieve the outcomes and comply with the new core duties/principles</li> <li>•Education linked to sophistication of firms (i.e. not one size fits all)</li> <li>•SRA website revamped to focus on providing greater guidance on "high-risk" concerns</li> <li>•Greater interaction with firms and other stakeholders through informal consultation groups prior to formal consultation</li> <li>•Guidance to Head of Legal Practice (HOLP) and Head of Finance and Administration (HOFA) used as guidance on good practice management for all firms</li> <li>•Consumer education programme rolled out via website and leaflets regarding standards to be expected of Firms</li> </ul>