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## The GUISE guide to Outcomes Focused Regulation

The new SRA rulebook was published on 6 April 2011, and will come into force on 6 October 2011. As busy practitioners, what do you need to know?

Before considering how the new rules will be applied by the regulator, we need to consider what the new rules are and how much change they introduce.

There are three main differences between OFR and the Code of Conduct 2007:

- It is not prescriptive
- The handbook contains only principles and indicative behaviours (IBs)
- There is no supplementary guidance

The theory behind the new outcomes-driven approach can be seen in what are now simply known as the SRA principles. The table below includes a comparison of the 2007 Code of Conduct's Core duties and the SRA Principles in the new Code of Conduct.

2007 Code of Conduct Core duties	SRA Principles – You must:
<b>1.01 Justice and the Rule of Law</b> You must uphold the rule of law and the proper administration of justice	1 uphold the rule of law and the proper administration of justice;
<b>1.02 Integrity</b> You must act with integrity	2 act with integrity;
<b>1.03 Independence</b> You must not allow your independence to be compromised	3 not allow your independence to be compromised
<b>1.04 Best interests of clients</b> You must act in the best interests of each client	4 act in the best interests of each client;
<b>1.05 Standard of Service</b> You must provide a good standard of service to your clients.	5 provide a proper standard of service to your clients;
<b>1.06 Public confidence</b> You must not behave in a way that is likely to diminish the trust the public places in you or the legal profession	6 behave in a way that maintains the trust the public places in you and in the provision of legal services;
	7 comply with your legal and regulatory obligations and deal with your regulators and ombudsmen in an open, timely and co-operative manner;
	8 run your business/or carry out your role in the business effectively and in accordance with proper governance and sound financial and risk management principles;
	9 run your business/or carry out your role in the business in a way that encourages equality of opportunity and respect for diversity;
	10 protect client money and assets.

The first six of these top-level principles are identical to rule 1 of the core principles in the Code of Conduct 2007. However, note the principles numbered 7-10 inclusive. These introduce an emphasis on business planning and the sanctity of client funds that has never been present in previous sets of professional rules for solicitors.

This approach will enable the regulator to concentrate its resources on business models that rely too heavily on, for example, large introducers of work, or on models that have a slim profit margin, thereby endangering the business viability of the regulated entity. This approach widens the scope of the regulator's view beyond what is at present in rule 5 of the 2007 code, which covers business management.

## The structure of the new Code

The Code is divided into 5 Sections:

Section 1: You and your client

Section 2: You and your business

Section 3: You and your regulator

Section 4: You and others

Section 5: Application, waivers and transitional provisions

These sections contain chapters which include both Outcomes and Indicative Behaviours. These reflect the principles. The Indicative Behaviours include behaviour which is both indicative of compliance and of non compliance with the principles. Some of the provisions contained within these sections are considered below.

## Section 1: You and your client

### **Chapter 1 - Client Care**

Chapter one of this section is Client Care. The table below compares the Outcomes under this chapter with Rule 2 in the Code of Conduct 2007.

<b>Code of Conduct 2007 Rule 2</b>	<b>Client Care Outcomes</b>
No equivalent	<b>O(1)</b> treating your clients fairly
No equivalent	<b>O(2)</b> providing services to your clients in a manner which protects their interests in their matter, subject to the proper administration of justice
<b>2.01 Taking on clients</b> (1) You are generally free to decide whether or not to take on a particular client. However, you must refuse to act or cease acting for a client in the following circumstances: (a) when to act would involve you in a breach of the law or a breach of the rules of professional conduct 2) You must not cease acting for a client except for good reason and on reasonable notice.	<b>O(3)</b> when deciding whether to act, or terminate your instructions, you comply with the law and the Code
<b>2.01 Taking on clients</b> (1) You are generally free to decide whether or not to take on a particular client. However, you must refuse to act or cease acting for a client in the following circumstances: (b) where you have insufficient resources or lack the competence to deal with the matter	<b>O(4)</b> you have the resources, skills and procedures to carry out your clients' instructions

<p><b>2.02 Client care</b></p> <p>(1) You must:</p> <p>(a) identify clearly the client's objectives in relation to the work to be done for the client;</p> <p>(b) give the client a clear explanation of the issues involved and the options available to the client;</p> <p>(c) agree with the client the next steps to be taken; and</p> <p>(d) keep the client informed of progress, unless otherwise agreed.</p> <p>(2) You must, both at the outset and, as necessary, during the course of the matter:</p> <p>(a) agree an appropriate level of service;</p> <p>(b) explain your responsibilities;</p> <p>(c) explain the client's responsibilities;</p> <p>(d) ensure 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</p> <p>(e) explain any limitations 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.</p> <p>(3) If you can demonstrate that it was inappropriate in the circumstances to meet some or all of these requirements, you will not breach 2.02.</p>	<p><b>O(5)</b> the service you provide to clients is competent, delivered in a timely manner and takes account of your clients' needs and circumstances</p>
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Indicative behaviours (IBs) under these outcomes include:

Dealing with the client's matter - **IB(1)** agreeing an appropriate level of service with your client, for example the type and frequency of communications

Fee arrangements with your client - The table below compares **IB(11)** with **Rule 2.03** of the Code of Conduct 2007 Rule 2.

Client Care Indicative Behaviour	Code of Conduct 2007 Rule 2
<p><b>IB(11)</b> clearly explaining your fees and if and when they are likely to change</p>	<p><b>2.03 Information about the cost</b></p> <p>(1) You must give your client the best information possible about the likely overall cost of a matter both at the outset and, when appropriate, as the matter progresses. In particular you must:</p> <p>(a) advise the client of the basis and terms of your charges;</p> <p>(b) advise the client if charging rates are to be increased;</p> <p>(c) advise the client of likely payments which you or your client may need to make to others;</p> <p>(d) discuss with the client how the client will pay, in particular:</p> <p>(i) whether the client may be eligible and should apply for public funding; and</p> <p>(ii) whether the client's own costs are covered by insurance or may be paid by someone else such as an employer or trade union;</p> <p>(e) advise the client that there are circumstances where you may be entitled to exercise a lien for unpaid costs;</p> <p>(f) advise the client of their potential liability for any other party's costs; and</p> <p>(g) discuss with the client whether their liability for another party's costs may be covered by existing insurance or whether specially purchased insurance may be obtained.</p>

Please see:

Richard Buxton Solicitors v Mills-Owen (2010) EWCA Civ 122  
<http://www.bailii.org/cgi-bin/markup.cgi?doc=/ew/cases/EWCA/Civ/2010/122.html&query=richard+and+buxton+and+mills&method=boolean>

Reynolds v Stone Rowe Brewer [2008] EWHC 497 (QB) (18 March 2008)  
<http://www.bailii.org/cgi-bin/markup.cgi?doc=/ew/cases/EWHC/QB/2008/497.html&query=reynolds+and+stone+and+rowe+and+brewer&method=boolean>

**IB(23)** ceasing to act for a client without good reason and without providing reasonable notice.

Much of this may not seem that different to the position under the 2007 code. However, there is to be no guidance, and a solicitor's approach to achieving compliance will take into account business methodology and whether the business is sound or not.

### **Chapter 3 - Conflicts**

A specific concern for litigators was set out in the Law Society's response to the first OFR consultation, specifically dealing with the OFR treatment of conflicts of interest:

*"The current rules have evolved over time and are generally accepted to be clear and easy to follow. The proposed models do not reflect the subtleties that have evolved within the current rule and which ensure that clients are protected. We believe that it is likely to be to the detriment of clients to sweep away the detail within the rule ... We do not believe, in this instance, that an outcomes-focused approach provides sufficient clarity."*

In the new handbook, conflicts are dealt with under Chapter 3. There are five outcomes, including the following:

- O(1)** you have effective systems and controls in place to enable you to identify and assess potential conflicts of interests;
- O(2)** you do not act where there is an own interest conflict;
- O(3)** you do not act if there is a client conflict unless the circumstances set out in outcomes 4 or 5 apply;
- O(4)** where there is a client conflict and the clients have a substantially common interest in relation to a matter or a particular aspect of it, you only act if:
  - a) you have explained the relevant issues and risks to the clients and you have a reasonable belief that they understand those issues and risks;
  - b) all the clients have given informed consent in writing to you acting;
  - c) you are satisfied that it is reasonable for you to act for all the clients; and
  - d) the sole purpose of the transaction is not the conveyance of land".

Again, these provisions are not dissimilar to the position under the 2007 Code. Where the difference comes is in the absence of any guidance, and the much wider remit of the regulator under relationship management.

Terence Jeffrey Sopel [2011] SDT 9644 of 2007 (decision not yet published)  
 Barry John O'Brien [2007] SDT 9574 of 2006 (Reasons: 02.08.07 - Freshfields)

## **Section 2: You and your business**

### **Chapter 7 – Management of your business**

**“Everyone has a role to play in the efficient running of a business, although of course that role will depend on the individual's position within the organisation. However, overarching responsibility for the management of the business in the broadest sense rests with the *manager(s)* of the firm. The *manager(s)* should determine what arrangements are appropriate to meet the outcomes. Factors to be taken into account will include the size and complexity of the *firm*; the number, experience and qualifications of the *employees*; the number of offices; and the nature of the work undertaken”**

While stating that **everyone** has a role to play in the running of a business, overarching responsibility for the management of the business is reserved for the managers of the firm. Nevertheless “everyone” emphasises the important role non-managers play in ensuring compliance is achieved.

The Outcomes in this section include:

- O(1)** you have a clear and effective governance structure and reporting lines
- O(3)** you identify, monitor and manage risks to compliance with all the Principles, rules and outcomes and other requirements of the Handbook if applicable to you and take steps to address issues identified.

Indicative behaviours include:

- IB(1)** safekeeping of documents and assets entrusted to the firm
- IB(2)** controlling budgets, expenditure and cash flow.
- IB (8)** describing overheads of your *firm* (such a normal postage and telephone calls and charges arising in respect of client due diligence under the Money Laundering Regulations 2007) as *disbursements* in your advertisements.

In connection with IB(8) bear in mind the salutary tale of Shoosmiths:

**Andrew Robert Tubbs (Shoosmiths) – Regulatory Settlement Agreement 08.02.11**

<http://www.sra.org.uk/consumers/solicitor-check/127302.article?Decision-1>

This is another example where the rules may add little to the management practices in many solicitors firms due to the lack of detail. The goals of “effective governance” and “compliance with all the principles” may be difficult to self assess and firms with management issues may not be able to resolve these without more guidance or outside influence.

### **Section 3: You and your regulator**

#### ***Chapter 10 - You and your regulator***

This Chapter governs the relationship between the firm and the regulatory bodies, primarily the SRA and LeO.

Outcomes in this section include:

- O(1)** you ensure that you comply with all the reporting and notification requirements in the Handbook.
- O(2)** you provide the SRA with relevant information to enable the SRA to decide upon any application you make, such as for a practising certificate, registration, recognition or a licence and , whether any conditions should apply
- O(3)** you notify the SRA promptly of any changes to relevant information about you including serious financial difficulty, action taken against you by another regulator and serious failure to comply with or achieve the principles, rules, outcomes and other requirements of the Handbook.

This part of the Code raises questions over how OFR really differs in practice to a prescriptive rules approach. The introduction to the new SRA handbook states that the mandatory outcomes may be achieved in a variety of ways. The intention is clearly to inject flexibility into the ways in which firms achieve compliance. However, when the outcomes are drawn so specifically as they are above, adding the word “must” after “you” makes no difference to the application of the rule. There are not many different ways that you can “notify the SRA promptly of any changes to relevant information...”; the satisfaction of certain requirements are just not flexible in nature.

This is not to say that the incorporation of a principled approach is misguided. It does highlight however that in certain areas a prescriptive approach is needed. Similarly, a principle based approach is useful in areas where there is room for flexibility in how compliance is achieved. This will be the cases where it does not matter how a certain outcome is achieved but just that the end product is satisfactory. The regulatory regime must therefore incorporate both a principled and prescriptive approach to make room for areas which are flexible and areas which are not.

**Section 4 – You and Others**

***Chapter 11 – Relations with third parties***

**“The conduct requirements in this area extend beyond professional and business matters. They apply in any circumstances in which you may use your professional title to advance your personal interests.”**

Chapter 12 deals with separate businesses and the legal services which can and cannot be provided through a separate business.

A separate business is defined in chapter 14 as “a business which is not an authorised body, a recognised sole practitioner, an authorised non-SRA firm or an in-house practice and includes businesses situated overseas.” What a separate business can and cannot do is therefore a crucial structural element of the entire ABS regime.

The purpose of the chapter is to protect clients when they obtain mainstream legal services.

This chapter defines two kinds of service; “mainstream” and “solicitor like”.

A separate business can offer “solicitor like” services but not “mainstream”, which can only be provided through an authorised firm.

Mainstream services, or alternatively, prohibited separate business activities, include “the conduct of any matter which could come before a court, tribunal or inquiry, whether or not proceedings are started.”

Outcomes in this section include:

- O(1)** you do not:
  - a) own
  - b) have a significant interest in, or
  - c) actively participate in a separate business which conducts prohibited separate business activities.
  
- O (3)** where you
  - a) have a significant interest in,
  - b) actively participate in,
  - c) own, or
  - d) are a firm and owned by or connected with a permitted separate business,

you have safeguards in place to ensure that clients are not misled about the extent to

which services that you and the separate business are offering are regulated.

Therefore the protection is achieved first of all by stopping those regulated by the SRA from providing mainstream services through an unregulated business. The second stage of protection is designed to ensure that when those regulated by the SRA carry out “solicitor like” services for a separate business, clients are clear about the distinction between the two types of work. This is a complex framework which includes:

- \* businesses defined by the services they provide,
- \* businesses defined by virtue of whether they are regulated; and,
- \* activities which are defined by virtue of the business which usually undertake them.

It must be questioned whether simplicity and workability has been achieved in such a framework.

### **Section 5 – Application, waivers and interpretation**

Chapter 15 of this section is concerned with Commencement, repeals and transitional provisions. The SRA Code of Conduct comes into force on 10 August 2011 in respect of licensable bodies and on 6 October 2011 the relevant provisions of the Solicitors Code of Conduct 2007 will be repealed.

#### OFR – How?

OFR is modelled on the Financial Services Authority’s (FSA’s) “Treating Customers Fairly” project, which overhauled financial services regulation in 2007. In other words, the new regime represents a light-touch approach to delivering outcomes for consumers. It also reflects the approach adopted by Investors in People some years ago.

The adoption of the FSA’s approach to regulation, widely derided for bringing about the biggest economic disaster of modern times, may not be the best precedent to follow in regulating a business sector. However, at the time of the new rules’ introduction, the FSA said this:

*“Our Principles are rules. We can take enforcement action on the basis of them; we have already done so; and we intend increasingly to do so where it is appropriate to do so.”*

David Edmonds, chair of the Legal Services Board (LSB), said in a speech to the Hildebrandt Institute conference on 6 October 2010:

*“Change ... [has] ... been about reshaping regulation to better reflect the realities of practice ... we have sought to move away from burdensome rules and towards outcomes.”*

Hence the SRA’s name for this project – Freedom in Practice - Better outcomes for consumers.

In practice, the SRA will apply a formula, under what is known as risk-based regulation, to arrive at a risk rating of all the regulated entities for which it is responsible:

$$\text{risk} = \text{impact} \times \text{probability}$$

This may become highly controversial as, in all probability, qualifying insurers will seek to learn the SRA’s risk rating before underwriting a firm’s risk. Challenges to firms’ risk ratings will therefore assume great importance, and this will need to be managed through an, as yet absent, appeals process. Risk ratings will be communicated to the firm but not published on the SRA web site. Nevertheless it is expected underwriters will be very interested in the risk rating accorded by the SRA to any firm when renewing their professional indemnity insurance.

It is worth noting that the SRA regulates almost 11,000 law firms at present. It is still developing the methodology for arriving at risk ratings and still lacks the IT to make it all happen. Risk ratings are therefore unlikely to trouble any firm at the 2011 renewal. However, it is coming and £20m has been set aside to fund the new computer systems required to handle the data.

Two fictional examples provided by the SRA themselves may help to illustrate the new approach:

*OFR in practice: Example 1*

Venn LLP is a national law firm outsourcing disclosure. The regulator assesses its profile in the profession as being in the medium to high probability range of a breach of confidentiality occurring, and it therefore puts the impact as high. This is addressed by way of a SRA relationship manager being in regular contact with the firm to ensure appropriate steps are taken to address any possible breach of client confidentiality either, for example, through individual breaches by people, or via hacking.

*OFR in practice: Example 2*

Nokes & Co is a two-partner firm receiving claims via a referral company. Complaints have been received by the SRA from neighbouring solicitors firms and from members of the public about a lack of transparency in respect of referral fees. Relationship management takes place on a smaller scale, to deal with the specific concern. While the probability of a breach is, significant the firm, is small, its profile in the profession relatively low, and the impact therefore lower, leading to an overall risk rating of medium. The referral fees issue is dealt with by the SRA meeting with the partners, to ensure that the firm is committed to doing the right thing.

What do we need to do now?

If your firm is compliant today, then it will probably still comply after 6 October 2011. However, the new approach is coming, and it is best to start planning now – undertaking what the SRA call **Transition Planning**. This will involve the regulated entity gaining an understanding about itself, its business risks and how it functions, by undertaking and analysing client surveys and trends in complaints, and acting upon the outcomes of those analyses. All this represents a firm building a sound business.

Many of the issues thrown up by OFR and relationship management can be effectively addressed by becoming accredited with LEXCEL, the Law Society's quality and risk management tool. Version 5, which will address OFR, is due out in October 2011.

The combination of ABSs and OFR means that firms must plan their development much more carefully than ever before. They must also be able to prove the business planning that they have undertaken.

If in doubt, seek advice.

**This technical paper has been written as a general guide only. It should not be relied upon as a substitute for specific legal advice. No responsibility can be accepted by the author or the firm for any loss occasioned as a consequence of acting or refraining from action on the basis of this paper.**

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