

Everything you wanted to know about OFR but were afraid to ask

The Legal Press is full of talk about Outcomes Focused Regulation and the challenges it poses for the profession in adjusting to a new regulatory regime. The SRA says OFR will be lighter touch but in fact the new approach requires a great deal more thought and effort than the present regime.

What does OFR mean in practice? This article tries to illustrate the risks and the benefits that can come from preparing your firm for the new landscape in regulation that will arrive after 6 October.

OFR or OMG?

The first thing is to understand the new terminology. The table below provides a quick guide:

A guide to the new terminology	
ABS	Alternative Business Structure
OFR	Outcomes-focused regulation – a new principles based approach, and, says the SRA, an end to “box-ticking”
Principles	The 10 precepts behind OFR, replacing the “rules” in the Solicitors’ Code of Conduct 2007
Outcomes	Sitting beneath the principles, these are what each principle is designed to achieve
IBs	Indicative Behaviours – sitting under the outcomes, these are ways of behaviour that “may tend to show that you have achieved these outcomes and therefore complied with the principles”. They can also be used to show you have NOT achieved the necessary outcomes and may not have complied with the Principles.
RBR	Risk-based regulation – the concept that lies behind OFR
LSB	Legal Services Board
Transition planning	The key to a smooth transition of your firm to the new approach. The SRA expects firms to plan ahead to enable them to remain compliant.
LDPs	Legal Disciplinary Partnerships – a firm which includes both solicitors and one or more other lawyers and / or up to 25% non-lawyers. These have been permitted since March 2009. All LDPs will have to convert to ABS status by March 2012. However, there will be passporting for existing LDPs.
Relationship management (RM)	Part of the new supervisory experience – out with the box-tickers and in with a touchy-feely collaboration with your regulator.

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

- It is not prescriptive.
- The handbook contains only Principles, Outcomes 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:
Justice and the Rule of Law 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
Integrity You must act with integrity	2. act with integrity
Independence You must not allow your independence to be compromised	3. not allow your independence to be compromised

Best interests of clients You must act in the best interests of each client	4. act in the best interests of each client
Standard of Service You must provide a good standard of service to your clients.	5. provide a proper standard of service to your clients
Public confidence 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 Duties in the Code of Conduct 2007. The procedures and practices which you currently maintain in order to remain compliant with the current rules will certainly be sufficient to achieve compliance under the new principles. However, principles 7-10 inclusive introduce an additional focus into the core framework.

Engaging with the SRA and the Legal Services Ombudsman (LeO)

The current obligation to engage with the regulator (rule 20.05 2007 Code of Conduct) is elevated by Principle 7 which puts the way in which efficient regulation is achieved at the forefront of the new regime. This Principle gives the SRA licence for a more robust approach when it comes to policing the way the regulated community engage with them. Of course, the current approach could not be said to be lax.

The key to compliance with this Principle is effective business management of your regulatory obligations. Keeping pace with the SRA is as important, and sometimes as difficult, as keeping pace with a client or opponent and therefore sufficient resources and procedures need to be put in place to ensure your firm is prepared. The roles of the Compliance Officer for Legal Practice (COLP) and Compliance Officer for Finance and Administration (COFA), which all firms must appoint under the new Handbook, will assist in creating a focus on regulatory compliance. This will be not dissimilar to the focus which is given to the money laundering via the role of the Money Laundering Reporting Officer, a concept with which all firms will be familiar.

Business Management

Principles 8 and 10 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.

To ensure compliance with these Principles it is again necessary to have an effective business plan. This entails identifying your client base, making sure you have effective marketing strategies in place to reach those clients and ensuring your practice is set up in a way so that it can fulfil those clients' goals while being a profitable and viable business. This will also 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.

This is what the SRA refer to as **Transition Planning**. The introduction of ABSs and the new Handbook together requires firms to be more aware than ever of their place in the market and how they will compete in the future.

In our experience these challenges can be most coherently addressed by seeking accreditation with the Law Society of England and Wales' risk and quality management standard, LEXCEL. A skilled LEXCEL Consultant will be able to guide you through the process of adjusting systems in the knowledge that LEXCEL (unlike ISO 9001 or similar standards) is specifically designed to match the requirements of the professional rules. Version 5 of LEXCEL is due out in Autumn 2011 and addresses the requirements of OFR. It is a one-stop solution to remaining compliant after 6 October.

RISK

Risk...what is it good for? Absolutely everything. Risk is the basis of regulation in the future.

The SRA will apply a formula, under what is known as risk-based regulation (RBR), to arrive at a risk rating of all the regulated entities

for which it is responsible:

risk = impact x 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. There is much uncertainty at present as the SRA have recently resiled from their previous position whereby they would communicate risk ratings to firms. They now say that once the criteria have been published firms can work out their risk ratings for themselves! Nevertheless we expect underwriters to 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.

Some 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.

Real life examples confirm that risk is far from fictional and can be expensive:

Risk in real life: Example 1

Andrew Crossley tried to take advantage of the new market for the delivery of legal services by accepting instructions from a client to write letters demanding £500 compensation from persons whom his client accused of illegally downloading and sharing material from the internet in breach of his client's IP rights. His fee was based on a contingency fee at 65% of the recoveries achieved. Striking out the claims the Judge ruled that this approach was too entrepreneurial.

The collapse of these claims has led Crossley to the SDT, and gives pause for thought when considering taking advantage of the SRA's Freedom in Practice approach.

In a separate but equally chilling development, Crossley's firm's server was hacked leading to the dissemination of thousands of confidential names and addresses of those accused of breaching his client's IP rights. Whilst his firm has ceased this has not prevented the Information Commissioner from investigating the breach of Data Protection laws and fined Crossley £1,000 for the breach. The Information Commissioner made it clear that had Crossley been trading the fine would have been £200,000. The ICO's investigation found serious flaws in ACS Law's IT security system:

- Mr Crossley did not seek professional advice when setting up and developing the IT system
- His IT systems did not include basic elements such as:
 - * A firewall and access control
 - * ACS Law's web-hosting package was only intended for domestic use
 - * Mr Crossley had received no assurances from the web-host that information would be kept secure
- While the firm should have been aware of their obligations under the Data Protection Act, they continued to act negligently and failed to ensure that appropriate technical and organisational measures were in place to keep personal

The answer is to take professional advice. Running a law firm is a risky business but with proper preparation those risks can be managed effectively.

Risk in real life: Example 2

We acted for a two partner firm of conveyancers who decided to merge with a larger firm to enable them to compete more effectively in the new legal market.

Prior to the merger the firm decided to bill all of its remaining WIP to ensure that the current partners would enjoy the benefits of the WIP themselves rather than sharing the fees with their new partners in the merged entity. Unfortunately they failed to send the bills

prior to transferring funds on account from client account to office account. That is a serious breach of rules 19 and 22 of the Solicitors Accounts Rules, 1998 which the SRA characterise as acting dishonestly. If proven, such an allegation usually results in being struck off.

This breach was picked up on a routine SRA investigation and led to a 4 year nightmare which only ended in the SDT and after the merger became a de-merger. Fortunately we defeated the allegation of dishonesty and the outcome was a fine of £15,000 and a costs order of about £20,000 plus endless hours of otherwise chargeable time lost in the preparation of their defence and, of course, substantial costs for mounting their defence.

The Tribunal's decision is SDT number 10294-2009 for March 2010 and is at:

<http://www.sra.org.uk/consumers/solicitor-check/prosecutions/tribunal-findings.page>

The lesson is caveat emptor! Make sure prior to a merger you take care to carry out regulatory due diligence on accounts rules compliance and general conduct.

Solution?

Visiting Manchester to take part in a Law Society Question Time event, Des Hudson, Chief Executive of the Law Society of England and Wales, said profitability and turnover among law firms increased during 2010. Hudson predicted more mergers during 2011 and 2012 and urged caution amongst law firms.

Mergers can be fraught with issues which trap the unwary. This article illustrates some of the problems and the need for careful business planning not only in the commercial sense but, from 6 October 2011, in order to meet regulatory obligations. If you are contemplating a merger then seek early advice about the regulatory implications.

Our VERACITY product (a fixed fee, due diligence tool) can assist to address the regulatory, accounting and IT issues which always arise both before, during and after merger.

Stay safe, take 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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