OPINION

Four years on: where are we now?

Peter Scott

Sometimes it is useful to stop, reflect and take stock, especially during times of momentous change

In issue 1 of the *Legal Compliance Bulletin* in May 2009, in his editorial, Peter Camp said that the new publication came at a time of unprecedented change for the legal profession in England and Wales as a result of the Legal Services Act 2007 (LSA). Since then that 'unprecedented change' has continued at a hectic pace and that pace of change is unlikely to diminish.

However, at the time of issue 1, Lord Hunt's independent review of the regulatory system necessary for the implementation of the LSA was still ongoing and it would have been difficult to predict accurately just how regulation of the legal profession would develop. It was therefore with some foresight that in that issue the editor commented:

'Practitioners cannot expect regulation to go away, or even, possibly, the current regime to be replaced by "light touch" regulation. The trend now surely is for detailed but proportionate regulation to be imposed in the public interest and for appropriate penalties to be applied for failures to comply.'

Those words were borne out by an article explaining Solicitors Regulation Authority (SRA) proposals for outcomes-focused regulation (OFR) in issue 6 of the *Legal Compliance Bulletin* in March 2010 in which Samantha Barrass, now executive director of the SRA, said:

'Nobody should confuse OFR with "light touch" regulation. Rather it is modern and proportionate regulation that treats solicitors as adults who have the ability and confidence to ensure that they are delivering good standards, without tying them in red tape. There will be no reduction in the overall standards required, but more focus on overall outcome rather than compliance with detail.'

We now have a regulatory regime which cannot be described as 'light touch' even though OFR was said at the time of its introduction, on 6 October 2011, to provide for 'freedom in practice'. To the contrary, OFR has extended both the boundaries of regulation and its impact on how law firms must operate, in ways which in 2009 could not have been foreseen by practitioners.

The encroachment of regulation

The increasing encroachment of regulation through OFR into every aspect of a law firm has been largely driven by principle 8 in the SRA Handbook which provides that:

'You must 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.'

Running a law firm in accordance with that principle should, of course, make prudent business sense. However, the requirement to do so is now, in addition, a matter of compliance and the particular area where such regulatory encroachment is currently most evidenced is financial management. Achieving financial stability is made a specific regulatory obligation by outcome 7.4 of the SRA Code of Conduct: 'You must ... maintain systems and controls to maintain the financial stability of your firm and ... take steps to address issues identified.'

As financial problems grow for many law firms and the number of interventions increases, caused by, *inter alia*, changes in legal aid, fee cuts for personal injury work, the referral fee ban, a continuing difficult economic climate and lenders tightening borrowing even further (which the SRA has called 'a toxic combination of factors causing a perfect financial storm for many firms'), financial stability has clearly become a major (if not *the* major) current priority for the SRA in its regulation of law firms. Samantha Barrass of the SRA, mentioned above, emphasised the current hard-line approach of the regulator in a speech on 18 April 2013 (available on the SRA website) when she said:

'We will not tolerate the reckless trading of firms into insolvency and where this happens we will pursue enforcement action under principle 8 [see above], *including referral to the Solicitors Disciplinary Tribunal where appropriate.'*

If anyone still had any doubts, that statement should dispel any continuing thoughts of light-touch regulation.

Looking further into issue 1 of May 2009 shows us how in other ways the regulatory scene has fundamentally changed in the intervening four years.

Entity-based regulation

The LSA introduced entity-based regulation and issue 1 included an article ('Entity regulation', Iain Miller, pp.10–11) explaining what this would mean for the profession and quoted from an SRA consultation paper ('New forms of practice and regulation', 9 January 2009) in which it was said:

'The SRA Board believes that there should be a significant shift in emphasis to taking action against firms, where appropriate, rather than individuals, although it will still be necessary to take action relating to individuals in certain circumstances.'

As the article explained, the very architecture of the LSA required a move towards entity-based regulation. With the introduction of alternative business structures (ABSs), the entity rather than the individual was to be the important point of regulation and this was embraced by the SRA. This was notwithstanding that the Financial Services Authority (FSA) had already changed its approach, the article quoting Margaret Cole who was at the time director of enforcement at the FSA:

'We have frequently stressed the importance of senior management responsibility and oversight ... Well, a recent study by Deloitte for the OFT confirmed what we already expected, that action against individuals has a lot greater impact in terms of deterrence than action against firms. So we know that taking

enforcement action against individuals is a vital part of achieving credible deterrence overall.'

It would seem that, despite the introduction of entity-based regulation, the SRA has since 2009 moved towards a similar approach with regard in particular to the regulation of 'traditional' (i.e. non-ABS) law firms, by focusing more on the responsibility of and enforcement against individuals. The introduction of the compliance officer for legal practice (COLP) and finance and administration (COFA) roles for traditional law firms (which are roles not specifically provided for by the LSA) would seem to bear this out.

The LSA provides that an ABS must have an individual who is designated as head of legal practice (HoLP) who must take all reasonable steps to ensure compliance with the terms of the ABS's licence, and a head of finance and administration (HoFA). In the context of entity-based regulation and an ABS, having senior individuals as compliance officers to carry out such functions is an understandable safeguard. The regulator will need to be able to look to an individual who values his or her reputation, career and pocket sufficiently to ensure compliance, and not to look just to the entity owning the organisation, however deep its pocket may be to pay penalties levied on it for compliance failures. As Iain Miller's article pointed out, the challenge for the SRA should be to preserve the best elements of individual regulation while allowing for the new structures established by the LSA.

Given the risk of bad publicity, complaints handling should be high on every law firm's list of priorities

However, who in May 2009 could have foreseen that the SRA would extend the roles of HoLP and HoFA to all law firms so that from 1 January 2013 every law firm would have to have a COLP and a COFA to 'police' the firm, roles which individuals in many firms are currently struggling to fulfil satisfactorily?

Entity-based regulation also means that every employee in a law firm is now subject to direct SRA regulation. It does somewhat beg the question as to why, if a firm and everyone in a firm can be called to account, it was considered necessary to impose specific compliance obligations on two individuals in every law firm, however large or small, and not just in an ABS for which the roles were intended? It remains to be seen how effective entity-based regulation will prove to be and how workable the roles of the COLP and COFA will be.

Complaints and publicity

Another (now very topical) matter on which issue 1 focused concerned the former Legal Complaints Service (LCS) and the proposal it had put forward to 'name and shame' solicitors in relation to complaints ('The LCS and publicity', Andrew Hopper, pp.5–6).

In early 2008 the LCS had promoted a consultation paper on its stated intention to name and shame solicitors against whom complaints of poor service had been upheld. As the article explained, this proposal provoked considerable hostility as being ill-conceived. However, in October 2008, the proposal was abandoned. The article hinted that this was unlikely to be the end of the matter and went on to discuss the Legal Ombudsman (LeO) scheme which was due to come into effect in 2010 and with it, pursuant to the LSA, the possibility of publicising LeO's decisions.

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Despite much opposition from the profession and much debate, closed complaints where an ombudsman's decision has been made are now published on LeO's website, although complaints resolved informally do not appear in the published information.

Given the risk of bad publicity, complaints handling should be high on every law firm's list of priorities. As Socrates said over 2000 years ago: 'Regard your good name as the richest jewel you can possibly be possessed of.' The need to avoid/manage complaints was re-emphasised in issue 24 of the *Legal Compliance Bulletin* in March 2013 in an article ('Changing the rules', pp.3–4) by Adam Sampson, the chief legal ombudsman, in which he discussed the recent changes to his organisation's scheme rules and why it was considered necessary to make these changes, dealing with time limits, complaints from prospective customers and case fees. LeO would like law firms to learn from complaints so that problems do not occur again. How much have law firms been willing to learn about avoiding and managing complaints since that article in May 2009? The list of firms named on LeO's website and the findings in relation to the matters complained of show that much more effort still needs to be made. It is a worthwhile exercise to look at LeO's website (**www.legalombudsman.org.uk**) to see what can be learned from it regarding how to avoid and, if necessary, manage complaints.

Ideally, law firms should manage their work in such a way as to prevent complaints being made in the first place, to avoid the risk of bad publicity. However, it is of course not possible to prevent people making complaints, whether justified or not, and so law firms really do need to become very good at managing complaints when they are made. Firms should consider just how much it will really cost (not only in direct financial cost but also in the time and effort expended) to resolve a complaint, whether or not it gets as far as a complaint to LeO. Complaints prevention is really where firms should focus their efforts.

Constant regulatory change

At the time of issue 1, regulation was relatively straightforward in that we had the Code of Conduct 2007 (updated in 2009), which set out rules, and it was 265 pages in hard copy format. Since 6 October 2011, in addition to numerous other additions and changes, the Code of Conduct 2011 is just part of the 600-page SRA Handbook, updated online each quarter and we are now using version 7 (as of 1 April 2013). Continuing regulatory changes may be necessary but that does put a burden on practitioners if they are to keep up to date to ensure they are

always compliant with regulation. Nothing is more dangerous for a lawyer than to be considering obsolete law and regulation.

To keep up to date now on SRA regulation requires the practitioner not only always to refer to the SRA website whenever considering the current regulatory position, but also to refer to the information sent out in almost daily emails from, *inter alia*, the SRA with its updates, from the Law Society with its 'Professional Updates' and from the online *Law Society Gazette*, not to mention the valuable regular updates and articles in the *Legal Compliance Bulletin*. Such information needs to be assimilated by those responsible for compliance and then disseminated internally if firms are to try to ensure compliance. And the avalanche of regulatory changes and information is unlikely to reduce. To keep fully on top of this really does require the services of professional compliance officers in law firms. Most firms will say they are not able to afford such a 'luxury'. My response to that is: 'Can they afford not to?'

The avalanche of regulatory changes and information is unlikely to reduce

Interestingly, in the chief legal ombudsman's article referred to earlier, he commented that:

'regulation imposes a very real burden on those having to comply with it ... It is reasonably easy to set up systems to comply with the rules. What really hurts, though, is when the rules are constantly changing and those systems have to change to meet them.'

Those words (he was writing in the context of changes to the LeO scheme) might be said to be a reflection of where we are today in relation to OFR. Who could have foreseen that in 2009?

Anti-money laundering regulation

Another topic discussed at length in issue 1 concerned anti-money laundering (AML) regulation and tipping-off and articles on AML have appeared in *Legal Compliance Bulletin* on a regular basis since then to help practitioners find their way through the maze of compliance as new regulations have been introduced. Yet more changes to AML regulations are now on the way and the latest, which were detailed in the March 2013 issue ('Fourth Money Laundering Directive: start planning for changes', Emma Oettinger, pp.15–16), concern the Fourth Money Laundering Directive published in February 2013. As that article explained, while the changes proposed will not have direct application to UK firms until at least the end of 2014, firms will need to familiarise themselves with the areas of potential change and take these into consideration when developing business plans and considering new compliance systems. How many law firms are currently taking steps to do this?

The need for resource

In his editorial in issue 1, the editor wrote: 'The time allocated to a consideration of regulatory issues by practitioners is, at best, limited.'

How times change. One of the major problems now facing law firms (particularly, but not exclusively, smaller firms) is how to provide (and to afford) the required resources, including time, to ensure compliance. Nominated COLPs have, for example, been asked by the SRA as part of the approvals process to confirm that they are satisfied they would have sufficient time and resources to allocate to the role, given fee-earning or other responsibilities.

One of the most fundamental changes to have occurred in relation to compliance with regulation of the legal profession since 2009 is that compliance can no longer be seen as something to be carried out in odd moments between client work or during evenings or at weekends. There needs to be a change of mindset on the part of practitioners so that compliance becomes an accepted part of everyday practice, with a recognition that, if it is to be carried out effectively, compliance is going to take up a substantial amount of time, and there will be a cost involved in this. Many large firms already employ groups of professional risk and compliance personnel. The challenge for the rest of the profession will be how to manage in a cost-effective manner their risks and compliance obligations both to protect themselves and to safeguard the interests of clients.

In his introduction to the new publication in issue 1, Peter Camp ended by saying:

'If we can assist the busy practitioner by providing a helpful and practical forum for information and education on regulatory issues, we will have achieved the most important of our goals.'

Given the current regulatory regime, the need within the legal profession for a helpful and practical forum for information and education remains as important as ever.

Peter Scott *runs his own consulting practice, Peter Scott Consulting.*

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