

Consultation response

Solicitors Regulation Authority: Achieving the right outcomes

Overview

1. **The Legal Services Consumer Panel welcomes proposals by the Solicitors Regulation Authority (SRA) to adopt an outcomes-based approach to regulation.**
2. **In particular, outcomes-based regulation – in requiring judgements to be made and responsibility taken by individual solicitors and the senior management of firms – ensures the objectives behind regulation are fully embedded in the thinking and practices of the firm.**
3. **In many ways the solicitors' profession is well suited to this style of regulation, although there are also some risks. Predictability and enforcement are the two areas that the SRA must get right to address these challenges.**
4. **The new code needs sufficient clarity and to strike the right balance between outcomes and rules. The SRA should draft this from a blank piece of paper, aiming to meet the challenges of the 2010s, rather than seek to adapt the existing model.**
5. This response has been informed by commentary on outcomes-based regulation in other sectors. In particular, we have drawn on work by Professor Julia Black¹ and an inquiry by the House of Commons Regulatory Reform Committee².

The proposals

6. The SRA intends to transform the regulation of solicitors and the organisations in which they work through an approach which delivers:
 - Outcomes-focused regulatory requirements 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;
 - 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 the SRA;
 - 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; and
 - Enforcement action which is prompt, effective, proportionate and creates a credible deterrent against failure to act in a principled manner.

The Panel's response

Benefits

7. An outcomes-based approach involves the regulator relying less on prescriptive rules that tell firms how to act, but instead defines the end goals that the regime seeks to deliver. This should give firms freedom to

organise their businesses in ways that ensure such outcomes are achieved.

8. This style of regulation has been used by the Financial Services Authority, but other regulators, such as the Financial Reporting Council, are also moving in this direction. General consumer law is also increasingly based on principles, for example the Consumer Protection Regulations create a general duty not to trade unfairly. The Legal Ombudsman will make decisions based on what is “fair and reasonable” – again, this approach is founded on principles.
9. The benefits of outcomes-based regulation are well-rehearsed. Firms are closest to their customers and the flexibility afforded by outcomes-based regulation allows them to innovate and adopt practices that meet their particular circumstances. An outcomes-based approach can prevent loopholes and help regulators adapt to the changing environment. It encourages senior managers to engage with the regulatory process and align the strategic direction of the business with the regulatory objectives. It should produce behaviour which is focused on the purpose behind the rule, rather than a tick-box mentality focused on the letter of the rules. A code of conduct centred on a small number of outcomes reduces complexity and focuses minds on the core behaviours that really matter.
10. In some respects, outcomes-based regulation would appear well suited to the solicitors’ profession:
 - Diversity of firms – solicitor firms come in all sizes, practise in a variety of specialisms and deal with a wide range of consumers and situations; the flexibility offered by outcomes-based regulation would seem preferable to a one-size-fits-all set of rules.
 - A changing sector – the legal services landscape is rapidly evolving, especially

with the advent of alternative business structures; outcomes-based regulation would appear better placed than rules to keep pace with such changes.

- Legal behaviour – lawyers are trained to spot loopholes and find routes-around restrictions imposed by rules. The existing forms of business structures designed to anticipate alternative business structures are a case in point; outcomes-based regulation is well suited to prevent “creative compliance”.
- Ethics – a strong ethical ethos is core to the identity of the solicitors’ profession; outcomes-based regulation is similarly founded on a core set of behaviours.

Meeting the challenges

11. There are some high-level issues that the SRA must successfully address if the new regime is to work effectively. Whilst there are some inherent risks with this style of regulation, we are confident that it should be possible for the SRA to manage these.
12. Partly, as the consultation document recognises, this involves developing the internal capacity of the SRA to ensure it has “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”.
13. We consider two substantive issues below:
 - Predictability
 - Enforcement

Predictability

14. A common criticism of outcomes-based regulation is that small firms in particular are unclear what they need to do in order to comply. This could produce adverse consequences for consumers if it leads to risk-aversion or reluctance to innovate.

15. Guidance appears to be the primary means by which the SRA intends to help firms to interpret the outcomes. However, whilst it is understandable for firms to desire certainty, too much guidance would defeat the very purpose of outcomes-based regulation: firms must work out for themselves what behaviours would achieve the outcomes. Further, the replacement of hundreds of pages of detailed rules with equal numbers of pages of guidance could produce a no less confusing picture. Any guidance should be kept short, explaining what the principles mean but stopping short of saying how they should be implemented.
 16. Another risk is that guidance becomes a means for regulators to introduce new rules by the back door that should instead be the subject of full and transparent consultation. "Retrospective regulation" is unhelpful for consumer bodies as they do not have the opportunity to provide expert advice on what protections are needed. It is likely that trade associations or market operators will produce guidance if the market demands it. The SRA should aim to introduce a minimal amount of guidance and exercise restraint in elaborating the meaning of the outcomes through public statements.
 17. It is important that consumers understand what they are entitled to expect from their solicitor. The SRA should aim to harness consumer power to drive up standards, alongside their own enforcement efforts. A clearly written set of outcomes is needed if consumers are to carry out this role. As well as the outcomes having clear meaning, the draft code should be written in plain language and tested with consumers to ensure it is comprehensible.
 18. Finally, it is important that the SRA and the Legal Ombudsman maintain close dialogue. Ombudsman schemes can take account of codes of conduct when considering what is fair and reasonable in each case. It would be unhelpful for everyone if interpretation of the principles by the regulator and ombudsman scheme greatly differed.
- ### Enforcement
19. Outcomes-based regulation can appear difficult to enforce as principles by their very nature allow for differences in interpretation. It can be difficult to enforce standards on recalcitrant firms which are willing to contest the regulator's decisions. Further, there is a risk that firms will try to get away with a minimum standard of conduct and so consumers are less protected.
 20. The SRA must send a clear signal that outcomes-based regulation does not mean lax regulation. In particular, the SRA must be willing to take enforcement action on the basis of the high-level outcomes rather than rely on the remaining detailed rules. Sanctions should bite on senior managers in firms as well as individual practitioners responsible for the breach.
 21. Clearly, however, there is a risk that an overly tough enforcement policy will drive unduly cautious behaviour among firms and reduce their willingness to innovate. A rulebook based on principles creates more margin for error as it requires interpretation. The SRA needs to strike the right balance. Its enforcement approach should be predictable, but also responsive to the behaviours demonstrated by each firm. A "materiality" approach might be needed to deal with minor departures from the outcomes. Equally, however, robust action should be taken against firms whose activities are wilfully or persistently non-compliant and cause consumer harm.
 22. Transparency should be a watchword of the enforcement regime. It will help produce a predictable regulatory environment as firms can learn from the behaviours of others.

Transparency combined with a proportionate approach, should give firms confidence about the level of discretion they have in seeking to achieve the outcomes. Equally, identifying those firms that have broken the rules through publication of enforcement action should act as a powerful deterrent against non compliance.

23. Finally, whether or not the SRA will be successful in enforcing the new code will depend on factors other than its wording and the enforcement approach. For example, the penalties for breaching the code must exceed the gains of not complying. The SRA should keep under review whether its sanctioning toolkit remains fit for purpose.

The new code

24. The Consumer Panel welcomes the stated commitment that the SRA is “not in any sense lowering the standard required from firms, and, therefore, the level of customer protection”. For the avoidance of doubt, our comments below relate to the style of the code; we understand the SRA will consult on the content of the code at a later stage.
25. The code needs to include an appropriate combination of high-level outcomes and detailed rules. Rules will remain necessary in certain situations, for example when it is desirable for firms to behave consistently, such as to help consumers make comparisons, or to communicate specific things that firms must not do.
26. The model as proposed does not deliver sufficient clarity nor strike the right balance between outcomes and rules. In particular, some “examples” of activities that would indicate whether outcomes are being achieved should be mandatory and therefore be written as rules. Instances where “examples” should be “rules” include providing relevant information to clients

about conditional fee agreements and having a written complaints procedure. This might be a case of confusing terminology; we cannot imagine that these activities are intended to be optional, but the code could be interpreted this way as presented.

27. We suggest an alternative model that sees outcomes and rules as a continuum. This approach would give the SRA more flexibility in the type of requirements it could place on firms. For example:
- High level outcome – consumers can achieve quick and fair redress using firms’ in-house complaint systems
 - Outcome based rule – you must give clients clear information about how to complain about your services
 - Prescriptive rule – client care letters must include details of your complaints procedure and a named individual responsible for handling complaints
28. The SRA should take a fresh view of what the core outcomes should be, starting with a blank sheet of paper rather than trying to reshape the existing Rule 1 provisions into outcomes. This is an excellent opportunity to rewrite the code around the risks that consumers face in today’s market. A small number of consumer-facing outcomes should form the centre-piece of the code and these should be expressed in consumer-facing terms as this reinforces the notion that consumers are the ultimate beneficiaries of regulation.

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¹ Julia Black, *Forms and Paradoxes of Principles Based Regulation*, LSE Law Society and Economy Working Papers 13/2008.

² Regulatory Reform Committee, *Themes and Trends in Regulatory Reform*, July 2009.