Legal Services Act: New forms of practice and regulation

Report on responses to consultation paper 15

Information to be sought from firms for regulatory risk-analysis – the practical approach for 2009

Introduction

1. This paper provides feedback on the responses to consultation paper 15 and the key points made by respondents. The consultation was published on 6 January 2009 and closed on 31 March 2009.

2. 30 responses have been received as follows:

   The Law Society (TLS) (Annex A)

   The City of London Law Society (CLLS)

   Cambridge & District Law Society (CDLS)

   Leicestershire Law Society (LLS)

   Tunbridge Wells Tonbridge & District Law Society (TWLS)

   Newcastle upon Tyne Law Society (NLS)

   City of Westminster and Holborn Law Society (WHLS)

   Sole Practitioners Group (SPG)

   Legal Services Commission (LSC)

   Legal Services Ombudsman (LSO)

   Legal Complaints Service (LCS)

   Association of Personal Injury Lawyers (APIL)

   Institute of Legal Executives (ILEX)

   Motor Accident Solicitors Society (MASS)

   Royal Institution of Chartered Surveyors (RICS)

   14 private practice firms

   Individual solicitor

3. The consultation sought views on proposals for collecting four pieces of additional information from firms regulated by the SRA to develop a clear picture of the possible risks to clients and to the public interest generally. It followed Consultation Paper 7 (CP7), which looked at information gathering for high level risk analysis. Following the consultation, the SRA is proposing to gather information in 2009 on:

   - turnover (gross fees)
   - areas of work

- levels of legal aid work
- negligence claims
- fee earners

4. As our risk-profiling capabilities are expanded along with our IT, it is envisaged the SRA will collect further information to develop our risk-based approach to regulation.

5. We received 30 responses and, although this was a relatively low response rate, we were pleased to receive input from a wide variety of respondents.

6. In brief, we found broad agreement on collecting the new information to benefit a risk-based approach. The main concerns were:

    - the need to define terms,
    - the need for reassurance that the information will be used appropriately and stored securely,
    - that notes accompany each question to ensure consistency of responses and that there is no risk of different understanding of terminology affecting the statistics.

    The Sole Practitioners Group (SPG), in their response, considered the proposed information requirements to be confidential in nature and as such, “the SRA are not entitled to this information.”

7. The SRA is engaged in a programme of reform to focus our regulation more effectively upon risk. The collection of information about firms is an essential part of any system of risk based regulation but we have designed the requirements to keep any extra burden on firms to a minimum. The information will be stored confidentially and will be used to create an overall picture of a firm.

    The consultation was the latest step in the process of developing a risk based approach to regulation, and the responses will feed into further work now being undertaken. This will include further consultation in future on other information that we might request, to help us gather the most appropriate information from firms, in the most practical manner.

    Following on from the feedback and further internal discussion, the SRA will be requesting the following new information of firms at renewal 2009:

    "What were your firm’s total gross fees from your last complete accounting period, arising from work undertaken from offices in England and Wales?”

    “Please state the number of fee earners (full time equivalent) currently based in your offices in England and Wales.”

    "How many claims were made against the firm in the last complete indemnity period?"

"How many claims were paid, whether by the insurer or the firm, in the last complete indemnity period?"

"Please provide a breakdown of the areas of work undertaken by percentage of your gross fees."[A list of work types will be attached.]

"What percentage of the above work is funded by legal aid?"

These are slightly different from the original questions as proposed in the consultation. They have been amended in light of the consultation feedback and internal discussion.

Responses to the questions

Turnover

> Proposed questions:
>
> "Please state the firm's total gross fees in your last complete accounting period, arising from work undertaken from offices in England and Wales."
>
> "Please state the firm's total gross fees in your last complete accounting period, from branch offices outside England and Wales."

8. In general, the responses to the wording of the turnover question were positive. Whilst some respondents considered turnover to be commercially sensitive, the majority felt it to be a useful piece of data for the purpose of risk based regulation, although not necessarily as a future potential fee modelling tool.

9. As raised in the feedback, and also acknowledged by the SRA, turnover on its own is not an indicator of risk. However, when put alongside other information, it helps to build up a picture of a firm. For example it may be easier to identify patterns of risk by comparing levels of fees to size of firm, work types and so on, or from significant fluctuations in fee levels over time.

10. The key theme in responses to the turnover question was the issue of definition. The respondents felt that the SRA need to be clear in what they consider to be gross fees and/or turnover in the wording of the proposed questions. The definition of gross fees below was given in paragraph 10 in the consultation.

    "The Minimum Terms and Conditions for qualifying insurers defines "gross fees" to include "all professional fees of the firm for the latest complete financial year including remuneration, retained commission and income of any sort whatsoever of the firm (including notarial fees)." What is specifically excluded is interest, reimbursement of disbursements, VAT, remuneration from a non private practice source, dividends, rents and investment profit." (We propose to replicate this in the guidance notes for completion of the renewal form)."

11. We agree with the responses that a clear definition of terms will ensure that equivalent data is collected from all firms. Productive analysis can not be completed if different firms are providing different figures because of uncertainty as to the concept of gross fees. Consistency of interpretation is crucial if used as a basis for fees.

12. The responses also suggested that firms would be easily able to provide the requested information, as long as it is in line with the insurers' information gathering as proposed.

    "We have no objection to the provision of this information, provided that the obligation will not impose any burden which exceeds that which currently exists in connection with our indemnity insurance. "(Private practice firm)

13. One respondent stated that many firms do not incorporate so that such information is not provided or published. The SRA will ensure firms are aware that we would not publish such information in a way that would attribute it to a firm and it will be used for internal risk profiling only.

14. Much of the response to the turnover question was given in the context of future fee modelling. Many respondents questioned whether this was a fair and proportionate approach to fee modelling and queried whether there were better variables upon which to base a fee model, such as number of employees. There will be future consultation on the proposed fee models.

15. Whilst turnover is an option for the basis of a fee model, it is not the only option, as recognised in the consultation feedback. Some of the responses also assumed that all of the risk information will be used for fee modelling purposes, this is not the case.

16. Concerns were also raised regarding the breakdown of gross fees from branch offices outside England and Wales. One private practice firm stated:

    "Given that firms practice outside England and Wales through a variety of corporate vehicles (e.g. branches of the LLP, local incorporated entities which are associated with the firm etc) it is in our view a bit arbitrary to single out branch offices."

17. Given the responses to the consultation, the SRA will ask only the first question regarding gross fees and not ask for extra information regarding branch offices outside England and Wales.

Non-solicitor fee earners

Proposed question "Please confirm the number of non-solicitor fee earners currently based in your offices in England & Wales."

18. The vast majority of responses to this question queried how the SRA will define the term non-solicitor fee earner and what groups of individuals the question aimed to identify.

    Examples of comments in relation to defining non-solicitor fee earners are:

    "There needs to be a definition of "non-solicitor fee earners" and possibly a de minimus for fees earned by such fee earners" (Private practice firm)

    "The proposed question is far too broad and easily capable of manipulation. Different firms will define fee earners in different ways. If the statistic is used for a fees based calculation it will easily be manipulated." (Private practice firm)

    "The question will need to define what a fee-earner is to avoid disputes arising as to whether or not an individual employed by a firm can be classed as a fee earner." (ILEX)

    "Consideration will need to be given to any impact that the inclusion of fee-earners in the regulatory risk assessment may have upon the employment position of non-solicitor fee earners. For example, if it increases the regulatory cost firms may opt not to employ non-solicitor fee earners." (ILEX)

    "We would like to know how "fee earners" is defined." (The Law Society)

19. Defining the term "fee earners" will clearly be necessary to ensure that firms are providing equivalent information. However, it is clear from the feedback that firms already have their own definitions, and the information provided by respondents is being fed into our development work.

    "They could be of widely varying grades and widely varying experience. It is not unknown for personal assistants to carry out a certain element of fee earning work. The aggregate number of non-solicitor fee earners would provide no useful information to the SRA on its own in assessing fee calculation." (Local Law Society)

20. It is proposed that the following definition of fee earner will be used:

    "Total number of Full Time Equivalent (FTE) individuals (lawyers and non-lawyers) generating fee income for a firm"

    Examples of fee earner roles:

- Solicitor or other lawyer e.g. barrister, legal executive, etc.
- Trainee solicitor
- Paralegal, research assistant, non-lawyer consultant
- Specialist support staff
- Professional support lawyers and lawyer managers (indirectly contributing to fee income)
- Support/administrative staff doing fee earning work

This would exclude support / administrative roles that might result in incidental expenses / disbursements e.g. photocopying

For this purpose a regulated individual working 3 days per week, should be counted the same as non lawyers who spent 60% of their time on activities which generate fee income and 40% on non-fee earning activities (e.g. admin support). Each of these individuals would represent 0.6 FTE

Negligence claims

Original questions:

"How many claims were made against the firm in the last complete accounting period?"

"How many claims were paid, whether by the insurers or the firm, in the last accounting period?"

21. The majority of respondents were opposed to the collection of negligence claims information. These concerns have been considered, but we have concluded that the information should be collected, as being relevant to risk. The responses to the consultation have been helpful in identifying how the information to be collected should be defined.

22. Again, as with the questions on turnover and non-solicitor fee earners, there were a significant number of queries on what the SRA considered being a "claim". The following observation by one local Law Society summarises most of the comments in response to this question:

    "there is no clear definition of claim. A definition is needed and must be distinguished from circumstances which may give rise to a claim."

23. The issue of what constitutes a negligence claim is a complex issue, highlighting the need to clearly define what information we are seeking to obtain. Definitions will be provided in the accompanying guidance notes.

24. One point raised by a private law practice was:

> "It might be easier for firms to report claims statistics by policy year ended during the 12 months prior to recognition renewal."

25. As we endeavour to model information requirements as far as possible on those of the qualifying insurers, the suggestion above is sensible. Firms renewing their recognition in October are likely to have recently informed their indemnity insurance provider of their negligence claims position, as well providing details of turnover. Therefore the information should be easily accessible for firms.

26. It is also acknowledged, as with the other new information requirements, information on levels of negligence claims alone is not necessarily indicative of risk. Other factors including types of work, complexity of cases and the financial market may be of influence. This is supported by respondents who commented:

> "We are concerned that the information being requested does not necessarily provide a true picture of the firm's record unless there is cross-referencing with, for example, the size of the firm, the number of fee earners etc." (Representative group)

> "We do not think the number of claims alone will serve any useful purpose." (Private practice firm)

27. In order to get an accurate picture of a firm's position in respect of negligence claims, the definition must be clear. If firms are providing information based on differing understandings of the term "claim," the data will be skewed and would not be reliable for analysis purposes.

28. A breakdown of suggestions as to what 'claim' might mean is provided below by some respondents:

- It should be redrafted to refer to claims which allege professional negligence or perhaps other significant professional misconduct requiring notification to the insurers. (Private practice firm)

- The information requested should be confined either only to claims paid or to be confined to claims which are represented by receipt of a claim form or letter of claim under the professional negligence pre-action protocol. (Private practice firm)

- A simpler option may be to align the question with the information that firms are obliged to notify to insurers, i.e. claims and circumstances, although many of these will be precautionary in nature. (Individual solicitor)

29. Other concerns regarding negligence claims were raised, in particular by a local Law Society. They commented that negligence claims represent an historic view of the firm rather than forward-looking and is therefore of limited use in terms of assessing the risk currently posed by any particular firm. This was supported by a private practice who stated:

"…so might tell you about a firm some years ago but not about the firm you are regulating now or in the future." (Private practice firm)

30. The SRA consider a firms approach to claims handling as relevant to risk. Whilst some claims may be historic, the processes in place to review and address claims made may be indicative of potential risks.

Work areas

> Proposed question:
>
> "Please provide a breakdown of the areas of work undertaken by percentage of your gross fees."[A list of work types will be attached.]

31. Following feedback on this consultation, we have amended the list of work areas for firms to use when categorising the sources of their turnover. It is envisaged that the work areas list will be reviewed and updated where necessary. In particular, it is thought that data from the SRA's supervisory regime with city firms will influence categories on the list.

32. The list attached to the consultation paper has been reduced considerably. We have considered the areas of work used by the five insurers with the greatest market share (a combined total of 70% according to the statistics held by the SRA's indemnity section) as a basis for the new list.

33. The updated work areas list also includes input and experience from other sections in the SRA currently dealing with risk assessment. The list is short and broad in places, but provides a starting point which can be expanded and developed if and when required in the future.

34. The CLLS were concerned that breaking down a firm's turnover by 58 work areas was not feasible. This view was considered when reducing the size of the list. A number of respondents also supported the approach of using the level of detail usually supplied to insurers.

    The updated list to be used by firms to break down their gross fees is attached at Annex B.

35. The Legal Services Commission suggested that the SRA consider confirming the percentage of legal aid work conducted by firms. The reason is that it would demonstrate the amount of work already subject to oversight and so be a positive indicator. This seems sensible and we will request an overall percentage of legal aid work in addition to the work areas question.

Other issues

Confidentiality

36. The CLLS highlighted the issue of confidentially as a major concern in their feedback to the consultation:

    "whilst the Law Society/SRA is not formally subject to the Freedom of Information Act (FOIA), given that the Law Society's Freedom of Information – Code of Practice voluntarily subjects the Law Society/SRA to the FOIA, it would potentially be possible for third parties to request copies of information supplied by firms."

37. The CLLS have asked that the SRA publicly state that the new information requested from firms will be supplied "in confidence" and will fall within an exception to the FOIA. This matter will be dealt with in the notes accompanying renewal forms, in which the information will be requested.

38. Similar concerns on confidentiality were expressed in much of the feedback. Another response expressed:

    "we have a concern over confidentiality and, in particular, the issue of whether information provided to the SRA pursuant of these proposals may become a matter of public record or be otherwise available pursuant to the Law Society's freedom of information policy."

39. The SRA will ensure that the risk data provided is for regulatory purposes only and will not be available in a way that links specific information to a firm.

Timescales generally

40. The CLLS requested that where the same information as is required by the SRA has been prepared for another purpose in the last 12 month period prior to recognition renewal, this information should be accepted by the SRA in lieu of the firm having to produce new information to the renewal date.

41. Due to the timings of the information requests from both the SRA and the qualifying insurers, we propose that the same data is used for both applications to allow firms to source data for both parties. This should be possible if we tailor our requests to dovetail with those of the insurers- although this will need to fit in with our risk assessment requirements.

42. We also considered whether it might be a better approach to select data relating to a specific date or covering a certain period of time. For example- requesting the number of non-solicitor fee earners within a firm as at 30 September. This was supported by a private practice firm who agreed and stated:

    "remove the word currently and replace it with a finite period."

The SRA will be asking for the information to be correct as at the date the renewal form is completed.

Conclusions

43. A previous consultation (Information gathering for risk assessment (CP7)) concluded that "there is widespread agreement that a risk-based approach is beneficial, although there are clear concerns amongst solicitors that this will result in an increase in regulatory requirements." The current consultation was the first to outline what new requirements there will be. The focus of this consultation was not on the principle of a risk-based approach but on how, and in what format, the information should be gathered.

44. The approach of mirroring our information requirements, as far as possible, on those of the indemnity insurers has been recognised by respondents as a positive step. In particular, it will address the concern of extra administrative burden for firms as the information we are initially requesting should be readily available. The timing of the collection, it is proposed, will coincide with the practising certificate renewal exercise.

45. All recognised firms (including recognised sole practitioners) will be subject to the same requirements. In light of the responses to our consultations and the fact that it will take some time to develop a sufficient database to provide a meaningful bank of information to draw on for risk assessment, we will collect information on an annual basis.

46. The SRA is committed to ensuring that our regulation is proportionate, and properly targeted to enhance public confidence in the profession and sustain high standards.

47. Taking this work forward, we are now finalising the wording of the new questions and make any amendments, where necessary, based on the feedback to the consultation. Definitions of terms will also be provided within the accompanying notes to the renewal forms to reduce the risk of inconsistent data.

48. The questions we consulted on are the first step towards a more developed information gathering process to assist with a risk based approach to firm based regulation. We intend to keep under review the effectiveness of the information gathered and then decide how to move forward from there. As advised in previous consultations it is likely the information requirements will develop. The initial information gathered will provide a baseline for that development. We can then begin to look for trends from analysis which will influence how we target our information gathering. Comments and suggestions given in response to this consultation may also influence what data we collect in the future. However, we are aware of the administrative burden on firms and intend only to request information to the extent that we believe it provides a useful tool in risk based regulation, and have the IT systems in place to store the information securely and analyse it meaningfully.

49. Further consultation will take place as and when the SRA develop further information gathering systems.

Annex A – The Law Society's response

The Law Society is the representative body for over 130,000 solicitors in England and Wales. The Society represents and supports the profession and lobbies on their behalf to regulators, government and others.

We welcome the opportunity to comment on the Solicitors Regulation Authority (SRA) Consultation Paper 15. This paper outlines the information that the SRA proposes to require from firms as part of the recognised body renewal process in October 2009. The information would be used to help the SRA develop both a new fee strategy for 2010 onwards and risk based regulation.

We strongly support the SRA's efforts to reduce the administrative burden on firms to comply with these requirements. The SRA has attempted to request the same information that firms commonly provide to insurers. We would like to emphasise that the format in which the information is requested should follow, insofar as possible, the requests made by insurers.

The SRA proposes to request information about non-solicitor fee earners. We would like clarification on three points. First, we question whether insurers commonly request this information from firms and therefore whether firms would be able to provide it easily. Second, we would like to know how 'fee earners' is defined. We note that some firms regard all their client-facing personnel, including secretaries, as fee earners. These personnel record time appropriately. Many, however, adopt a much more restrictive interpretation. Third, we would like to know how the SRA will use this information to expand its options for fee modelling as stated in paragraph 14. It would be unfair to charge a firm extra for having a larger number of such personnel, unless there was a history of problems with the firm. If properly supervised, these firms should pose no extra regulatory risks.

The SRA proposes to request information to show the breakdown of a firm's work types by percentage of the firm's gross fees. We are concerned that this request would be unworkable for firms. Firms adopt work type categories that are most relevant to their own management accounting priorities. While insurers request information about work types, the way in which that information is requested differs according to the insurer. We also question whether this information will be effective in demonstrating regulatory risk, which is quite distinct from civil liability risk. Therefore, the attempt to impose standard work type reporting requirements on the whole profession will inevitably impose additional costs without necessarily providing any useful data.

The SRA proposes to request information about a firm's negligence claims history. We think that looking at claims paid is likely to give an outdated picture of the firm for two reasons. The first is that a single, isolated and unlikely to be repeated minor administrative error, such as a failure to register a company charge, can give rise to a disproportionately high claim. The second is that it will slew the SRA's view of the firm to a much more historical, rather than current, perspective. Claims may take many years to settle or be adjudicated upon. It would seem wrong if a firm were to suffer, through the imposition of higher fees for example, if they have shown in the interim an ability to rectify systemic faults.

We are otherwise satisfied with the wording of the proposed requests and the ease with which firms would be able to provide the requested information.

Annex B – Areas of work list for 2009/2010

List of work areas to be used by firms when breaking down their gross fees as part of the renewal process 2009

- Arbitration and dispute resolution
- Bankruptcy / insolvency
- Children
- Commercial / corporate work for public companies
- Commercial / corporate work for non-public companies
- Consumer
- Criminal
- Debt collection
- Discrimination / civil liberties / human rights
- Employment
- Family / matrimonial
- Financial advice and services (regulated by SRA)
- Financial advice and services (regulated by FSA)
- Immigration
- Intellectual property
- Landlord and tenant
- Litigation – other
- Mental health
- Non-litigation – other
- Personal injury
- Planning
- Probate and estate administration
- Property – commercial
- Property – residential

- Social welfare
- Wills, trusts and tax planning