



The Law Society

SRA consultation on indicative guidance on financial penalties

Law Society response
April 2013



SRA consultation on Indicative guidance on financial penalties – Law Society response

Key points

The Solicitors Regulation Authority (SRA) can only fine non-ABS £2000 and therefore this guidance is irrelevant to these firms and should only apply to ABS. We note the comments that the SRA may, in time, gain greater fining powers in relation to non-ABS however, it seems unlikely this will occur in the near future.

There are only a few ABS currently licensed (~0.1% of the total number of firms regulated by the SRA) and the SRA has only been regulating such firms for a year. Given the SRA's lack of experience in regulating in this area we believe such guidance is premature.

The guidance focuses on imposing fines on entities rather than individuals. However, the SRA's approach to entity regulation is unclear. In many cases only individuals are pursued, in a smaller number of cases both the individuals and the firm are pursued. This guidance is predicated on the SRA moving towards entity-based regulation but on the available evidence the SRA is not operating a clear and consistent policy in this respect.

The lack of consultation with the Solicitors Disciplinary Tribunal (SDT), given their role as an appeal body, is surprising.

Please find our answers to the detailed questions below.

Question 1 – Do you agree that the SRA should adopt some guidelines to assist decision makers in determining an appropriate sum for financial penalties? Or do you feel that the existing Financial Penalty Criteria are sufficient?

We agree that guidelines will be desirable in relation to ABS at some point. We would query the timing of producing this guidance, given the SRA's lack of experience in regulating ABS and the wide variety of bodies which have been licensed. The lack of experience in this area means the SRA has little to base its guidance on. We are also concerned that the SDT has not been involved in producing this guidance, given its role as an appellate body. It would not be in the interests of consistency or good regulation if the SDT were to adopt a different approach, and the SDT's current guidance in relation to the level of fines does not adopt anything comparable.

Question 2 - Do you agree that the guidance should be broad rather than attempting to categorise every misconduct which could occur in a law firm?

Creating guidance on levels of fines for the infringement of every rule in the handbook would make the guidance unwieldy and unusable (although in reality enforcement action normally only relates to a small subset of the rules). We note the SRA's view that it needs flexibility and agree that, given its lack of experience in the area, a certain amount of flexibility is needed.

Question 3 – Do you agree that a staged process for assessing penalties, by which a basic penalty is arrived at and then adjusted for relevant factors such as mitigation, is sensible? Or do you favour an alternative?

The SRA has provided limited information on which to base any decision. It has set out the types of guidelines that may be used and its preference for a step-by-step approach. It uses the Financial Services Authority (FSA) and Office for Fair Trading (OFT) as exemplars of this approach. However, it has not provided a proper critique of the differing approaches. This makes it difficult to comment on whether the SRA's conclusion is correct. It would be helpful to know how the OFT and FSA have found the approach to work in practice in relation to the firms they regulate. In particular, it would be useful to know if the approach works well across a range of different size firms and for both individuals and entities.

Question 4 – Do you favour categorising conduct as a list of characteristics or do you agree it is sensible to distinguish between the nature of the conduct and the harm caused as proposed in our guidance?

The SRA have provided no information on what the list of characteristics might be, so it is difficult to answer this question. We would agree that the seriousness of the conduct and the harm caused should have a bearing on the level of fine.

Question 5 – Do you feel that the method for assessing the seriousness of the misconduct is clearly set out in the illustration at annex 1? Do you have any suggestions on how this might be improved?

The nature of conduct can be assessed as being standard or serious. In order for conduct to be considered 'standard' a person will need to have fully cooperated with the SRA. While cooperating with the SRA is an aspect of assessing the nature of the conduct it should not be an overriding factor. Furthermore 'cooperation' should not be equated with instant or early admission. The SRA has not always correctly identified fault and solicitors should be free to defend themselves against allegations they feel to be unjustified without being penalised for doing so. We accept that it would be an

exacerbating factor when a denial is an indicator of a fundamental failure to understand the rules or very bad judgement but, especially within OFR where there may be a range of correct courses to follow and the regulated community is encouraged to exercise their own judgement, this must be approached with caution.

We believe that sanction should reflect the level of fault, rather than the measure of loss, redress being a matter for the Legal Ombudsman. We also find the SRA proposed manner of measuring harm unhelpful. There are three levels of harm – low, medium or high. Many of the factors to assess the category of impact are in fact a repetition of the categories. The factors include the loss / impact is minimal, moderate or significant, or in other words whether the impact was low, medium or high. The highest category includes 'significant loss or harm to a vulnerable person' but this adds nothing, as significant loss to anyone is covered in this category. The SRA also needs to include more detail about what might be a significant loss. For instance, is it the monetary value? If so, how does this relate to the impact, as for some the loss of a relatively small amount of money may have a significant impact. It is unclear what the assessment would be in a case of minimal loss but with significant consequent impact.

The SRA has not provided any commentary on its chosen mechanism for scoring and it is unclear as to why this is weighted in the way it has been (unless this is just a function of having two categories for nature and three for impact). It would be helpful to have more information on this.

Question 6 – What do you think is the best way to determine financial penalties:

- a) as fixed monetary sums**
- b) as a percentage of income or turnover**
- c) a mixture of two as described above**
- d) some other way?**

Sanction should reflect both the level of fault and the ability of the offender to pay (as to the latter factor, this is settled law in relation to fines imposed by the SDT, which the SRA should respect). No system which sets a fixed mechanism of calculation can be entirely fair. The turnover of a firm may be a relevant factor, but there are firms which may have a high turnover but very low profit margins (such as firms heavily dependent on public funding). Any system which fails to take account of this will be unfair. We accept that setting fixed fines for smaller firms creates a simpler system. However, in the example offered, the smaller firm (GHI Co) receives a fine of 7% of turnover compared to a fine of 2.5% of turnover for the larger firm (XYZ LLP). For this particular band, even firms with a turnover approaching £1 million would still have a fine of 3% of their turnover, as opposed to the 2.5% imposed on other firms. This is true for other fine bands. Thus the mixed approach suggested by the SRA unfairly penalises smaller firms.

Question 7

a) Do you agree that a distinction should be made between firms of greater means and other firms?

We note the SRA's view that firms of greater means will face disproportionately high fines. However, it is not clear as to how this conclusion has been reached. The monetary value may be high but that does not necessarily make the fine disproportionate. If the fine is not proportionate to the means of the paying party then this can be considered in the third step of setting a fine.

b) If so, what level of domestic turnover do you think should be used to distinguish firms of greater means from other?

See above

c) Or do you think there should be different categories which taper the percentage applied?

See above

Question 8 – Do you agree that one approach to fines should be adopted for firms and individuals?

The consultation document concentrates on firms and provides no discussion about best practice when setting fine levels for individuals. We note the comment regarding sole practitioners in essence being individuals but given that this guidance will only apply to ABS (which by definition cannot be sole practitioners) this is not a valid argument. While we accept that similar guidance could be produced in relation to individual fines, the issues around this need to be explored more fully.

More importantly, there needs to be clarity about enforcement against individuals and entities. At the moment, the vast majority of enforcement action is taken against individuals and yet this guidance is based on fining entities (with individuals as an apparent after-thought). In the cases where entities are pursued, the individual managers are also often pursued, leading to a situation of 'double jeopardy'. We would hope to see the SRA adopting a more entity-based approach to enforcement on a consistent basis, which is not what is happening at present. Until this occurs we would be very concerned about the SRA implementing this guidance or using its greater fining powers. Any future guidance on fining individuals should take account of entity fines and their impact on the individual.

Question 10 – What do you feel is the appropriate range within which the SRA should impose fines on regulated persons taking into account the SRA’s three objectives in this respect?

Given our views that the mixed approach of fixed fines and percentage turnover fines is inappropriate and given that the fine levels are based on that approach, it is difficult to comment to any helpful extent on this question.

11. Do you agree that the SRA should discount financial penalties to take account of mitigating factors? In particular, do you agree that the SRA should discount penalties for:

- a) the early reporting and full admission of conduct?**
- b) promptly correcting any harm which has been caused?**

We have previously raised concerns about the SRA’s emphasis on ‘full admission’. The SRA can make mistakes. Regulated persons should not be put in a position where they believe they must admit all allegations even where they believe some are incorrect. Cooperation with the SRA is also considered in stage one meaning that there is an element of crossover between the first stage and the discount stage.

12. Do you consider that the percentages proposed for discounts are set at an appropriate level? Or do you consider that some or all of the percentages set out in the illustration at Annex 1 should be higher or lower?

We note that a high level of discount that might be offered. If these factors are important to setting the level of fine (as the high level of discount indicates), they should influence the fine band rather than be used at the end of the process as way of giving firms a ‘discount’.

A discount can only be given where there is early reporting *and* full admission. We are not clear why this should be the case. If a person recognises there is an issue and reports to the SRA then they are complying with their regulatory requirements. It is not clear why a full admission of guilt is required. A regulated person has the right to dispute allegations and to have the evidence properly considered by a decision maker. The level of discount and the link to self-reporting indicates that the SRA would like to dissuade regulated persons from exercising this right.

13. Do you have any comments on our proposed approach to removing profit or gain which has arisen as a result of misconduct?

We understand the motive behind this step. However, there needs to be clarity about how this would work in practice. A firm may have made a profit while breaching the regulatory requirements, but it does not follow that all the profit relates to the breach and should therefore be removed. The SRA needs

to do further work on how they would approach removal of profit and consult on this before adding in this step.

14. Do you consider that guidance of this nature is likely to have a negative impact upon a specific section of the legal service market and in particular a specific equality strand?

As has been shown, the fixed fee bands impose proportionately larger fines on smaller firms than big firms. Evidence shows that BME solicitors are more likely to be involved in smaller firms. Thus they are likely to be disproportionately affected by this guidance. We are surprised this has not been identified by the SRA and we are disappointed that a full equality and diversity assessment has not been undertaken.