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SRA FOCUS ON FINANCIAL STABILITY

Do you remember the time when law firms were the banks' favourite customers, practice failures were unheard of and the Law Society assumed that all firms were solvent? Heady days.

Not without reason did the new Code introduced on 6 October 2011 impose duties on law firms to manage their firms effectively (Principle 8) and to report serious financial difficulty. This represented a shift of priorities for the regulator, but it was triggered by increasing concerns about the viability of an increasing number of firms. Financial stability would also become a concern for the supervision team within the SRA and firms would face increasingly detailed financial questionnaires as part of the practice renewal process.

There can be no doubting that the focus of the SRA has now shifted noticeably towards financial stability. Regulatory compliance does not guarantee financial success, so how will this be measured? First, all firms are obliged to monitor for their financial stability (O(7.4)) and to *"take steps to address issues identified"*. This is coupled to a requirement to notify the SRA *"promptly of any material changes to relevant information about you including serious financial difficulty"*. A *"head in the sand"* approach to financial problems will therefore amount to a potential disciplinary issue.

As to how the SRA will handle all this information, it was announced at a recent Law Society Risk and Compliance Conference that three key indicators will be used: drawings exceeding profits; borrowing exceeding net assets; and borrowing over a certain level. Added to this will be a traffic light classification - red/amber/green. If a firm has two or more key indicators it is red-rated; one indicator amber-rated and none green-rated. The supervisory processes will, not surprisingly, be mostly directed at those firms rated in the red category.

All of which takes us to the sad events resulting in an SRA intervention at local firm Blakemores, where financial instability was the concern. There was no suggestion of any dishonesty, irregularities with the client account or with the conduct of client work. Three partners and their files had already transferred to another firm. Other similar arrangements were being made.

The timing could not have been worse. The staff were due to be paid on the day of the intervention but lost out as the SRA froze the bank accounts. Hundreds of personal injury clients have been left trying to secure a new solicitor and ATE insurance before the deadline of 1 April. The intervention agent is anxiously ringing clients but at what cost? Some clients will inevitably lose out.

Because of the size of the firm the intervention costs will be substantial. The SRA has admitted to £800,000 to £1m so the end figure will probably be higher. The SRA will not be able to recover these costs from the former partners of Blakemores so they will fall on the profession.

So why did the SRA intervene on that particular day? Was it decided to intervene two weeks before Easter to fit in with holiday commitments?

What was the difference between an intervention on that date and one week later when the staff had been paid and fee earners had been allowed to transfer their files to other firms? We may never know the definitive answer.

More general concerns could be raised as to the ability of the SRA to be a financial watchdog. It is not immediately clear if it has the qualification and resources to fulfil this role. We must all be concerned as to the expenditure of the practising certificate income in intervening in large firms that are already facing financial ruin and what might come from it.

The powers granted to the SRA to intervene extend to the protection of client files and the protection of client account. Where there is no risk to client account or client work would it not be better to appoint an interim manager to oversee the orderly run down of the firm – an administration before a winding up? As elsewhere in the commercial world the priority should be to save what can be left as a going concern, not to impose the immediate closure of the practice. ■

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