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SRA non-ABS financial penalties – LSB response to MoJ

The MoJ has asked for views on the SRA's request to increase the level of penalty that it can impose on non-ABS firms. This document sets out the LSB's response.

Summary

The LSB considers that there should be a substantial interim increase, to a level that is a credible deterrent to the largest law firms, in the maximum penalty that the SRA can impose on non-ABS individuals and entities that it regulates. We consider that this would enable the SRA to meet the regulatory objectives in the Legal Services Act 2007 (LSA) more effectively and efficiently and would be consistent with the better regulation principles and best regulatory practice.

The LSB also considers that the current structure across all approved regulators/licensing authorities for penalties and appeals is fundamentally flawed. There are large differences in, for example, levels of penalties, standards of proof, appeal processes and appellate bodies. This is likely to be increasingly problematic as different lawyers practise together and as ABS develop. The LSB is therefore conducting work to analyse these issues but we consider that the issue for the SRA is sufficiently serious to justify a change now.

Discussion

1. The LSB starts from the principle that a regulator must be able to decide, taking into account the regulatory objectives and better regulation principles, what sanctions are appropriate for breaches of its Code/Handbook/Rules, subject to LSB oversight of its regulatory arrangements.

2. It is absolutely right that there must be an independent appeal/review process against a regulator's decision in order to correct against inadvertent error and/or safeguard against inappropriate regulatory zeal. That appeal/review process may be an internal one for some issues but must always be to an external body for issues that concern, for example, rights to practise or large financial penalties.

3. It is normal practice for regulators in many other areas of the economy to both investigate an alleged breach of rules and, in a quasi-judicial capacity, impose a penalty/sanction on bodies that they regulate. Decisions about the appropriate

penalty/sanction are normally taken at Board level. In the absence of a specific right of appeal, those decisions can be judicially reviewed.

4. The overall approach in introducing ABS has been to make as level a playing field as possible between ABS and non-ABS. This approach is not yet, however, reflected in the position on penalties/sanctions. The SRA currently has to pursue significant rule breaches by a non-ABS firm by taking the case to the SDT (or by negotiating a regulatory settlement agreement), whereas it can impose a significant penalty directly on an ABS for exactly the same rule breach. It is thus possible for a firm's decision on whether or not to apply for an ABS licence to be influenced by the perceived harshness of one regulatory regime as opposed to another, rather than being driven by proper commercial incentives. The LSB considers this to be very undesirable.

5. Moreover, the LSB does not consider that the current position, in its confusion of regulatory and judicial roles, represents best regulatory practice. Both the LSB and the SRA must have regard to the better regulation principles and best regulatory practice.[1] In particular, the SDT is not subject to the LSA requirements to act in a way that is compatible with the regulatory objectives and to have regard to the better regulation principles. The fact that the SRA has to cede its regulatory decisions to the SDT in all but the most minor cases means that decisions on regulatory sanctions are being taken by a body that is not obliged to act in a way that is compatible with the regulatory objectives or have regard to the better regulation principles. In addition, the SRA's ability to negotiate regulatory settlement agreements is constrained by the low level of the current penalty (£2,000) and, even if it does reach a regulatory settlement agreement that it considers appropriate, if the case has already been issued by the SDT, the SDT has to agree to an allegation being withdrawn. It should be for the regulator to decide whether there is an appropriate conclusion to an investigation, not an external party with a different statutory remit.

6. The Legal Ombudsman maximum award is £30,000 plus any reduction in fees – so the final award could be substantially more. The Legal Ombudsman is currently consulting on whether that limit should be raised to £50,000. It seems anomalous that the Legal Ombudsman's maximum is currently 1500% greater than the regulator's, with the result that it can make larger awards to an individual consumer for poor service than the SRA can impose to deter and punish misconduct in relation to the generality of consumers. This mis-match of powers -- and, in particular the need for there to be substantial discretion at the upper end of the range of penalties to ensure a suitably powerful deterrent effect - again supports the need for a substantial increase in the SRA's maximum penalty.

[1] LSA section 3(3) and section 28(3))

7. We do not accept MoJ's point in its response to the SRA's paper that:

> *The [SRA's] proposals are based on the assumption that the risk posed by traditional firms is similar to that associated with ABSs. This may be true for those ABSs which the SRA characterise as being only subtly different from traditional firms, but does not take account of the need to provide a higher ceiling for ABSs which involve significant corporate investment.*

   We consider that the more proportionate and targeted approach is to consider the largest non-ABS law firms in setting an appropriate maximum penalty. Only by doing that will the penalty operate as an effective deterrent (and thereby be consistent with the better regulation principles). For example, Allen and Overy turnover in 2009/10[2] was £1.05bn and profit per equity partner was £1.1m.

8. Any argument that the current level has been set at the correct level because there have not been any appeals is spurious – a firm is most unlikely to appeal against a penalty of £2,000, whatever reputational damage has been incurred, to a body that can increase the penalty.

9. We note that the LSA[3] amended the Solicitor's Act 1974[4] to increase the SDT's penalty powers from £5,000 to an unlimited amount. This precedent guided the LSB's thinking in relation to the scale of penalties for ABS and we consider that it is also a useful comparator in considering the case for a substantial increase in the SRA's maximum penalty.

   Conclusion

10. We accept that the power that the Lord Chancellor has to increase the amount of penalty that the SRA can impose cannot be used to fix all of the structural and incentive problems created by the current arrangements. The LSB is taking forward in the medium term a project that will encompass those issues. However, the SRA does not currently have sufficient powers to impose proportionate penalties and its powers are ceded to a body that is not bound by the regulatory objectives or better regulation principles. We therefore consider that MoJ should make a substantial interim increase in the SRA's maximum penalty to a level that represents a credible deterrent for the largest traditional law firms.

[2] http://www.allenovery.com/AOWeb/binaries/56693.pdf
[3] LSA schedule 16 paragraph 48
[4] section 47