



Walk the line

The SRA's recent revelation that it has already exceeded its annual intervention budget doesn't surprise **Susanna Heley**. And there are tougher times to come

The legal profession is facing tough times. A perfect storm of increasing costs, decreasing cashflow, pressure from lenders and increased competition means that there are lots of firms which are struggling with their finances. Already in 2013 some reasonably well known firms have gone under and the SRA expects to exceed its intervention budget for 2013 with the combined cost of just two interventions of larger firms estimated at £1.8m against a total annual budget of £1.3m. The SRA has carried out 11 interventions so far in 2013 which, again, far exceeds predictions.

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The SRA has expressed concern about lawyers and law firms exhibiting “poor behaviours” by raiding VAT and tax accounts and over extending borrowing. While recognising the difficult economic situation, the SRA has also pointed its finger squarely at managers of law firms who fail to deal with the consequences of poor results. Particularly in the firing line are those firms which are dominated by one or more personalities who have such an entrenched position that it is difficult for other partners to make informed decisions about the management of the firm.

Protecting consumers

It is not the role of the SRA to prevent law firms from failing. The SRA's remit is to ensure that the interests of clients are

protected in requiring solicitors to recognise and address problems. Financial instability is clearly a risk to the interests of clients and to the overall reputation of the profession and the SRA as a responsible risk based regulator must seek to address the risk.

It has introduced a banding system to “RAG” rate the top 600 law firms based on the presence of three risk factors:

1. Drawings exceeding profits
2. Borrowing exceeding net assets
3. Excessive borrowing generally

Firms which exhibit two or more of these risk factors are deemed high risk – red rated – and will be subject to intense supervision, asked to prepare detailed contingency plans and required to consult insolvency practitioners. The ultimate aim is for the SRA to assist the firm in an orderly wind down without the need for an intervention.

Firms exhibiting one risk factor will be amber rated and subject to an enhanced level of supervision, including the provision of detailed financial information monthly. The objective will be to encourage proper financial management so that the firm has the best chance to get back onto a solid financial footing.

Firms not exhibiting any financial risk factors will be subject to minimal (presumably additional) supervision.

It is not quite clear why the SRA has limited its RAG rating exercise to the top 600 firms, although it is presumably related to the potential consequences when larger firms fail and the likely number of people directly affected by such failure.

The financial stability of firms is one of the SRA's key focuses for this year. There is little sign that the market will improve, particularly in light of changes to regulation and costs arising out of the Jackson reforms

and LASPO. The collapse of large firms clearly demonstrates that there are serious issues which the profession must address.

Head in the sand

Solicitors facing insolvency have a very difficult line to tread, balancing the needs of clients with obligations to creditors and staff. In addition, partners and managers whose firms may be facing insolvency need to be particularly careful that their conduct is above reproach. Not only may they face disciplinary proceedings for failure to comply with the SRA principles, the SRA may also take into account a history of personal or corporate financial mismanagement when making decisions on authorisation, particularly authorisation as COFA, in the future.

It is important for solicitors facing insolvency to seek advice from someone who is aware of the specific issues which arise as regards solicitors and law firms, in particular with respect to the operation and management of client account and the need for proper engagement with the SRA to deal with regulatory issues arising and avoid the possibility of an intervention.

It is not appropriate for partners to bury their heads in the sand and hope to trade through; decisions taken in the face of potential insolvency must be based on proper advice and have due regard to professional obligations. The consequences of failure to deal with these issues are potentially catastrophic.



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