



## Guidance

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#### **Sole practitioners and small firms regulatory starter pack**

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### **Introduction**

This starter pack provides help and support to people who are looking to establish their business. Creating the right legal and regulatory framework, and making sure that the business and its clients are protected at the outset, is vital for a start-up to achieve its full potential.

This pack can help sole practitioners and small firms consider key risks and how they could manage them, depending on characteristics such as size of firm, work type and client base.

This resource has been put together with reference to our [Risk Outlook \[https://jobs.sra.org.uk/archive/risk/outlook/risk-outlook-2019-2020/1\]](https://jobs.sra.org.uk/archive/risk/outlook/risk-outlook-2019-2020/1) which offers help for firms on risks we are seeing in the legal market. This pack will be reviewed at key stages depending on feedback we receive on the key compliance issues effecting small firms and sole practitioners.

Key risk areas set out in this pack include:

- Resources - allocation of resources to help effectively manage your firm
- Managing your finances
- Succession planning for sole practitioners/small firms
- Misuse of client money/failing to protect client money and assets
- Bogus firms - protect your identity and brand
- Data Protection and Security

In our experience, the risks are key areas for new start-ups to consider when providing effective legal services. Our approach to regulation provides greater freedom for lawyers to design and deliver services, to run their business and engage with the legal market as they see fit.



As part of our ongoing programme to help firms to comply with our regulation, we hope that this pack will help you engage positively with clients and the SRA.

We have also included links to recently published guidance, warning notices and questions of ethics which may be useful tools as you develop your firm.

This advice does not form part of the [SRA Standards and Regulations](https://jobs.sra.org.uk/solicitors/standards-regulations/) [https://jobs.sra.org.uk/solicitors/standards-regulations/] and is not mandatory. You will need to contact our professional ethics team for specific advice relating to this, as you consider appropriate.

- [Resources](#) [#Collection\_1]
- [Finances](#) [#Collection\_2]
- [Succession plans](#) [#Collection\_3]
- [Client money](#) [#Collection\_4]
- [Bogus firms](#) [#Collection\_5]
- [Data protection](#) [#Collection\_6]
- [Further reading](#) [#Collection\_7]

## Resource allocation

### **Resources - how can you allocate resources to effectively manage my firm?**

Law firms of every type and size, including sole practitioners and small firms, increasingly need access to greater resources if they are to function effectively, as legal practice becomes ever more competitive.

But for small firms, in particular you might need to consider:

- How can the most critical functions be prioritised and resourced in a cost effective manner?
- Is outsourcing the answer?
- If the necessary resources cannot be accessed - are there any alternatives?

When considering how resources can be deployed, all firms still need to make sure that they are maintaining client confidentiality. And informing clients of any arrangements in place for the referral of work and any related fee sharing agreement.

All firms we regulate need to be able to demonstrate their ability and willingness to manage risk and meet the required regulatory outcomes. For example:

- If you are considering proposals to share offices with third parties or other companies within the group structure of a firm – how will



- client confidentiality be protected?
- If you would like to outsource any of your firm's functions – what activities are undertaken by the outsourced service provider you would like to use? Will they be within a suitable jurisdiction? How will the quality of their work be monitored?
- If you are looking at governance arrangements for your firm – how will the firm be governed? If there are managers in the firm do they have the necessary skills and the right attitude to being regulated in order to achieve the right regulatory outcomes? Have the right people been nominated as your firm's compliance officer? Do they genuinely have the experience and time to fulfil these roles?

## **How can you find out what the main risks are that I may need to allocate resources towards?**

When allocating resources and prioritising key tasks it is important that the key challenges facing the legal profession are kept in mind. All firms including those starting-up need to take appropriate steps to protect against risks to themselves, their clients and the wider public interest.

## **Managing your finances**

### **What signs could indicate your firm is in financial difficulty?**

Sole practitioners don't need to worry about partners but they do need to understand how to make money and always have sufficient cash flow to meet their business needs. In recent years we have seen an increased number of firms in financial difficulty.

The growing scale of this problem is a significant factor in our view of this as a key risk in the legal services market. This trend is driven by a wide range of economic and commercial pressures.

While our role is not to prevent financial failure, it can lead to other significant risks, such as disorderly closure, poor standards of service, criminal association and the misuse of client money.

Key characteristics of firms at risk of financial difficulty include:

- management weaknesses – eg excessive concentration of power, limited sharing of financial information and inexperienced management below senior partner level
- accounting weaknesses – eg inadequate budgetary controls, weak cash flow planning and an inability to understand profit generated by different types of work
- change handling – eg failure to adapt to a changing market or to the changing needs of employees and customers.



## **What can you do to manage my firm's finances effectively?**

Firms need to be live to any financial problems to achieve a timely resolution. They should be able to deal with the issues early, adapt their business model and establish a commercial future for themselves.

If it is necessary to close your firm, effective management should mean an orderly closure without the need for us to intervene. This requires you to work with us to have in place exit or succession plans.

Firms that do not properly address financial difficulty, or who take steps to cover up problems, may find themselves in breach of the SRA Standards and Regulations. This includes misrepresentation of their financial position or knowingly trading while insolvent.

To help manage finances and throughput of work to help deliver improved results firms may need to consider:

- Improving matter efficiency without diluting quality
- Agreeing fees with difficult clients
- Turning more of your time into cash
- Making your terms of business more commercial.

Sometimes these are not easy. So we have set out the approach we have taken to dealing with this risk amongst the firms we regulate, which highlights key lessons learnt from this experience.

Research into the characteristics and risks associated with firms in financial difficulty has also been completed which illustrates how financial difficulty can act as a good predictor of firms that present a high risk to the interests of clients and the public interest.

## **Succession planning for sole practitioners/small firms**

### **What is it and why is it important?**

Succession planning should be high on the agenda for sole practitioners and small firms as they face the prospect of retirement or selling their interests in the firm for other reasons. Planning ahead is key to successfully managing the process.

It refers to a strategy that allows owners to leave the business while allowing it to continue trading under new ownership. Our experience has shown that a lack of succession planning is often associated with retirement of partners in firms or sole practitioners not leaving enough time to allow an acquisition of their practice before they retire.



## What do we expect from a succession plan?

Our expectation is that firms will have an exit plan that will allow it to be wound down in an orderly manner or taken over by new owners. For some firms, exiting the market in a way that delivers profits for existing owners will be a central objective of their business plan.

However, an exit strategy should also be in place in case a firm is no longer able to continue trading. This could be a result of:

- the firm no longer being economically viable
- the death or serious illness of the sole practitioner, a managing partner or key member of staff
- a failure to obtain professional indemnity insurance
- regulatory requirements or controls ( eg a sole practitioner has a practising certificate suspended or with conditions).

A lack of succession and exit planning creates a risk to the continuing commercial viability of a firm. This becomes a regulatory concern because it undermines a firm's ability to deal with financial difficulties and other risks. This can lead to a range of scenarios with the potential to have a negative effect, including disorderly closure, poor standards of service and fraud and dishonesty.

The SRA Code of Conduct for Firms (paragraph 2.4) requires those we regulate to “...*actively monitor your financial stability and business viability. Once you are aware that you will cease to operate, you effect the orderly wind-down of your activities...*”. Part of good business management is having contingencies in place, such as an exit or succession strategy.

Having plans in place does not mean that you will necessarily have to use them, but it reassures us that abandonment and other types of negative effect are unlikely. If you do not have credible plans in place for succession or exit, and we have evidence that the firm may close in a disorderly way, it may be necessary for us to intervene into the practice.

## What should be referred to when I developing a succession plan?

When considering succession planning or an orderly wind down, the following questions may help to inform your decision:

- Do you have anything to sell?
- What are your options?
- How can you put in place clear and achievable plans to meet your objectives?
- Have you contacted sources of advice such as business experts, local chambers of commerce, local Law Societies, support



groups/networks?

- Do you understand how to implement a succession plan?
- Have you considered our [guidance](https://jobs.sra.org.uk/solicitors/guidance/closing-down-your-practice/) [<https://jobs.sra.org.uk/solicitors/guidance/closing-down-your-practice/>] on closing down your practice and engaged with the SRA?

## **What about insurance run-off cover?**

When a firm closes without a successor practice, our minimum terms and conditions of compulsory professional indemnity insurance require run-off cover. This where the qualifying insurer 'on risk' at the date of the closure to provide cover for the balance of the period of insurance and for a further six years thereafter. This protects consumers who need to make a claim after the firm closes.

Where a firm closes due to a succession by a successor practice, then any future claims relating to the closed firm will be covered by the qualifying insurer on risk for the successor practice at the date the claim is made. This can deter firms from acquiring other practices as they may not want to take on the responsibility for potential run-off claims.

## **Changing from being a sole practitioner to an SRA regulated freelance solicitor**

If you are currently a sole practitioner and your practice is authorised as a recognised sole practice, you may also be considering transitioning to become a freelance solicitor. Here are some key points you need to think about in deciding whether to make the transition:

- A recognised sole practice is a type of firm authorised by us, whereas a freelance solicitor is authorised by us as an individual.
- So, if you move from being a sole practitioner to serving all of your clients as a freelance solicitor, you must therefore 'close' your recognised sole practice. By this we mean your business will cease to operate as an authorised firm. This also means you will need to have run-off cover in place.
- The cost of run-off cover should be one of the things you take into account as you consider changing from being a sole practitioner to being a freelance solicitor.
- It is possible for you to have both a recognised sole practice and work as a freelance solicitor in which case your recognised sole practice would not need to close. For example, you may wish to provide some non-reserved legal services, such as legal advice, independently of any reserved work you do through your recognised sole practice. As such work can be done outside of authorised practice, and therefore without many of the obligations attached to a regulated firm, you may wish to do that in a freelance capacity while maintaining your regulated firm for other work.



- Be aware, however, that it would be important that clients understood the difference between the two and were not confused as to the regulatory protections that applied. Such an arrangement would also not be suitable for case-splitting (ie dividing a case so non-reserved work was done by you as a freelancer and reserved work was done through your recognised sole practice) but may be suitable where the non-reserved work was distinct from, and independent of, that being done through the recognised sole practice.

## **Misuse of client money/failing to protect client money and assets**

### **Why is this so important?**

The obligation to protect client money and assets goes to the heart of the SRA Standards and Regulations, and in particular Principle 7 - to act in the best interests of each client. Our Codes of Conduct provide that both firms and individuals must “... *safeguard money and assets entrusted to you by clients and others...*”... Firms should make sure that they have proper systems and controls in place to ensure protection of client money, documents or other property belonging to clients.

### **What should a Compliance Officer for Finance and Administration be doing to help protect client money and assets?**

A Compliance Officer for Finance and Administration (COFA) provides an additional control and ensures that someone is responsible within the firm for financial oversight. They have a duty to report to us any facts or matters that they believe could be a serious breach of the SRA Accounts Rules.

As your firm grows and develops it is vitally important that you maintain systems and controls to safeguard money and assets entrusted to you.

Factors that may lead to client money or assets being misused are wide ranging and case specific. This risk continues to be a high priority for us because of the significant effect it has on the public's and consumer's interests.

Our compensation fund provides redress, and firms are required to remedy shortfalls that arise, it may lead to a negative effect on the legal matter being dealt with as well as causing distress and alarm to consumers. Dishonesty is also highly damaging to the public's confidence in the delivery of legal services.



This risk is more common if a firm is in financial difficulty, when money is sometimes misused to try and prevent the firm from failing.

A number of our interventions involve suspected dishonesty and many include accounts rule breaches amongst their grounds. When costs of intervention cannot be recovered in full from the intervened firm, they fall on those we regulate and eventually get passed on to consumers in the form of higher fees.

Sound financial practices and good use of the COFA role to maintain a strong dialogue with us are some of the ways that you can avoid problems in this area.

## **Bogus firms - protect your identity and brand**

### **What is a bogus firm?**

The term 'bogus firm' is used to describe situations where criminals take on the identity of a law firm in order to steal money or access information. As solicitors and their firms provide professional services and are generally well trusted by the public, criminals can carry out elaborate scams and frauds if they dupe someone into believing they are from a genuine law firm. We have seen an increasing number of bogus firms, particularly those involving identity thefts of an existing firm or individual.

### **What do criminals do?**

Some bogus firms target the public directly. These cases often involve criminals aiming to entice a consumer to engage with the bogus firm as if it were a genuine law firm. Others target genuine law firms, for example, this might involve setting up a false conveyancing transaction.

Bogus firms are a risk to consumers losing both money and confidential information. There is also a risk their existence will lead to a lack of public confidence in legal services or deter members of the public from seeking advice from law firms. Firms will also want to manage the risk of bogus firms due to the direct harm they can cause to their business in terms of reputational or financial damage.

### **What can you do to reduce the risk of a criminal trying to steal my firm's identity?**

Good practices that can be adopted to reduce this risk include:

- Making your website displays the [SRA's clickable logo](https://jobs.sra.org.uk/solicitors/resources-archived/transparency/clickable-logo/)





- Carrying out regular internet searches of your firm's name to check for identity theft
- Checking your firm's details published on the SRA's website are up to date and correct
- Being alert to suspicious incidents, such as when others seem to think your firm is dealing with a transaction you are not aware of
- Regularly checking the SRA's website for [scam alerts](https://jobs.sra.org.uk/consumers/scam-alerts/)
- Contacting our Red Alert line if you believe someone has stolen the identity of your firm or anyone working within it.

A [warning notice](https://jobs.sra.org.uk/solicitors/guidance/bogus-law-firms/) has also been published which provides more information about the threat and advice about how to protect yourself and others from it.

## **Data protection and security**

### **Why is data protection important?**

Your firm should have in place effective systems and controls to manage the electronic receipt and transfer of information. These systems and controls must make sure that client confidentiality and legal professional privilege is maintained in line with the regulatory requirements in the SRA Standards and Regulations.

Online crime has increased and impacts a wider range of firms. It presents a risk to client data and assets, as well as to the financial and structural stability of firms that are affected.

### **What can you do to make sure I am protecting data and keeping it secure?**

Examples of controls that you can adopt to manage key risks in this area include:

- Ending or restricting the use of data-sticks and email attachments, in favour of secure direct log-ins and online collaboration tools
- Keeping browsers, operating systems and anti-virus systems fully updated
- Making sure that only key staff can access those files that they need, to protect against insider attacks.

### **Can I use cloud computing at my firm to meet the requirements in this area?**

Small firms may not have significant IT resources available compared to other larger firms and may opt to introduce technologies such as cloud computing solutions. Data Protection related to cloud computing is a vital



area to keep up to date with. With the introduction of the General Data Protection Regulation, and the rise of BYOD (Bring Your Own Device) arrangements, the requirements in this area are changing fast. There have been a number of publicised cases on pitfalls of poor information management practices that are also relevant.

## Key SRA publications

### Guidance

- [Will writing](https://jobs.sra.org.uk/solicitors/guidance/drafting-preparation-wills/) [https://jobs.sra.org.uk/solicitors/guidance/drafting-preparation-wills/]
- [Preparing to become a sole practitioner or an SRA-regulated freelance solicitor](https://jobs.sra.org.uk/solicitors/guidance/preparing-sole-practitioner-regulated-independent-solicitor/) [https://jobs.sra.org.uk/solicitors/guidance/preparing-sole-practitioner-regulated-independent-solicitor/]

### Warning notices

- [Improper use of client account as a banking facility](https://jobs.sra.org.uk/solicitors/guidance/improper-client-account-banking-facility/) [https://jobs.sra.org.uk/solicitors/guidance/improper-client-account-banking-facility/]
- [Money laundering and terrorist financing](https://jobs.sra.org.uk/solicitors/guidance/money-laundering-terrorist-financing/) [https://jobs.sra.org.uk/solicitors/guidance/money-laundering-terrorist-financing/]
- [Money laundering and terrorist financing - suspicious activity reports](https://jobs.sra.org.uk/solicitors/guidance/money-laundering-terrorist-financing-suspicious-activity-reports/) [https://jobs.sra.org.uk/solicitors/guidance/money-laundering-terrorist-financing-suspicious-activity-reports/]
- [Referral fees](https://jobs.sra.org.uk/solicitors/guidance/referral-fees-laspo-sra-principles/) [https://jobs.sra.org.uk/solicitors/guidance/referral-fees-laspo-sra-principles/]

### Other

- [Reporting misconduct to the SRA](https://jobs.sra.org.uk/consumers/problems/report-solicitor/) [https://jobs.sra.org.uk/consumers/problems/report-solicitor/]