

Risk Outlook report: Serving clients' needs in a changing legal market

19 December 2024

Introduction

It is a difficult and uncertain time for many in the legal sector, with high costs, rapidly evolving technology, and changing client demand posing challenges to firms. To meet these challenges and use potential opportunities, some firms are changing the ways they operate.

This report:

- · presents some of the ways that firms are adapting to risks in the market
- considers the impact on clients
- · signposts to resources that support effective risk management.

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Changes in the legal sector

Many consumers are under financial pressure in a difficult economic climate, facing high interest rates and cost of living concerns during recent years. Citizens Advice helped a record number of people in 2023.

Demand in practice areas such as litigation, bankruptcy and employment remained high during this economic downturn. And recently, Thomson Reuters noted that transactional areas of law are starting to see growth in revenue due to firms' higher billing rates. This increase in pricing aims to offset the rising costs of higher interest rates and salary increases.

The Law Society's <u>Legal Needs Survey 2024 [https://www.lawsociety.org.uk/topics/research/find-out-what-your-clients-need-with-the-results-of-our-legal-needs-survey]</u> found that 66% of people surveyed have experienced a legal issue and only 21% believe justice is accessible. Consumers' financial difficulties and law firms' price increases could mean that people will struggle to get expert legal advice when they need it. Our <u>recent consumer segmentation research [https://referral.sra.org.uk/sra/research-publications/consumer-segmentation-research/]</u> found that some consumers assume legal services are unaffordable. Additionally, corporate clients continue to report a need to reduce costs

Due to the pressures of these financial difficulties, consumers are increasingly expecting their solicitors to:

- · be more efficient, using technological advances to help them
- · prove their value for money
- provide transparent information about the process, timeline and cost.

These expectations mean some firms are operating differently – eg by making technological, financial, structural or organisational changes. By adapting to meet these expectations, firms can help to drive trust and confidence in the legal sector, creating a dynamic market that is responsive to evolving risks and challenges. It also ensures that firms are better placed to use new opportunities.

Technological

The UK legal sector has reportedly become a 'global hub' for lawtech, with potential demand for lawtech products estimated to be worth up to £22bn year. Firms are increasingly adopting new technologies such as business intelligence services, and hiring more data scientists to gain further insight into their operational and financial performance. Firms are accelerating in their adoption and use of generative artificial intelligence (AI), particularly in larger firms and with a focus on back-office efficiencies.

However, despite this increased interest in new technology, there remains a lack of digital skills across all sectors in the UK. This could present a risk for firms and consumers if legal practitioners do not fully understand the new technology that is implemented. You should therefore make sure:

- appropriate training is given to all relevant staff when introducing new technology
- you remain fully compliant with your regulatory obligations when introducing new technology. <u>SRA Innovate [https://www.sra.org.uk/solicitors/resources/sra-innovate/]</u> can help you with any ethical or regulatory queries you may have. We also provide useful information in our <u>Lawtech Insight</u> [https://referral.sra.org.uk/news/lawtech-insight/] newsletter.
- you remain up to date with information security and <u>professional indemnity insurance</u>
 [https://referral.sra.org.uk/solicitors/standards-regulations/indemnity-insurance-rules/] obligations. The Information security. Commissioner's Office (ICO) [https://iroc.org.uk/] provides helpful resources on information security.

ΑI

Solicitors are reported to be increasingly eager to use AI, mostly for automating time-consuming tasks, such as legal research and drafting legal documents and communications. However there are continuing concerns



regarding the accuracy of outputs and data security. Our <u>Al Risk Outlook report [https://referral.sra.org.uk/sra/research-publications/artificial-intelligence-legal-market/]</u> has more information about the ways that Al can help your business along with the risks you might need to mitigate.

If AI speeds up the time taken to complete tasks, billable hours could become outdated and junior solicitors might be trained to complete complex tasks earlier in their careers than in the past.

Cybersecurity

Firms continue to be concerned about cybersecurity and associated supply chain risks. The 2024 Lawyer UK 200 survey found that more than 50% of the UK 200 firms cited cybersecurity as their biggest concern over economic instability or climate change. And the cyberattack on IT service provider CTS

[https://www.computing.co.uk/news/4150671/law-firm-service-provider-cts-hit-major-cyberattack#:~:text=A%20major%20cyberattack%20on%20CTS,it%20to%20a%20cyber%20incident.] — which delayed many conveyancing completions and affected around 80 law firms – highlights the potentially serious impact on

Given the impact of these types of attacks, you should consider the risks of overreliance on third party IT providers, as well as carefully managing the risks when replacing old manual or digital systems with new systems. This includes having continuity plans in place, including back up systems, so that you can continue to provide a service to clients.

The increase in meetings being held virtually means solicitors can be more flexible about where and when they work, which can be useful to meet consumers' needs. But you should also ensure that appropriate precautions are taken, eg for the risk of data being hacked or captured whether working at or away from the office.

The <u>National Cyber Security Centre [https://www.ncsc.gov.uk/cyberessentials/overview].g</u>ives thorough guidance on cybersecurity risk. And we have guidance and information on <u>cybercrime risks</u> [https://referral.sra.org.uk/solicitors/resources/cybercrime/] and your obligations towards clients.

Financial

Fee models

The 2024 Financial Benchmarking Survey found that in 2023, firms saw a reduction in billed and recovered hours, although firms made a profit in fee income overall.

The way that legal work is billed could significantly change for several reasons:

- Our consumer segmentation research found that consumers are demanding better pricing transparency, which some alternative pricing models can provide, as well as cost predictability.
- The increasing use of Al could speed up tasks that would usually be billed by the hour.
- Thomson Reuters found that many firms are dissatisfied with the traditional method of billable hours.
- A Litera 2024 survey of UK, US and Australian firms found that 70% had embraced Alternative Fee
 Arrangements (AFAs). Thomson Reuters reports that these AFAs are often based on a 'tasks completed'
 model or 'value-based pricing' model.
- More UK and international firms are considering flat fees, hybrid fees, contingent fees and subscriptionbased models.

If you have changed your pricing or fee arrangements, you must ensure that your firm still complies with our https://referral.sra.org.uk/solicitors/standards-regulations/transparency-rules/https://referral.sra.org.uk/sra/research-publications/year-three-evaluation-sra-transparency-rules/https://referral.sra.org.uk/sra/research-publications/year-three-evaluation-sra-transparency-rules/https://referral.sra.org.uk/sra/research-publications/year-three-evaluation-sra-transparency-rules/https://referral.sra.org.uk/sra/research-publications/year-three-evaluation-sra-transparency-rules/https://referral.sra.org.uk/sra/research-publications/year-three-evaluation-sra-transparency-rules/https://referral.sra.org.uk/sra/research-publications/year-three-evaluation-sra-transparency-rules/https://referral.sra.org.uk/sra/research-publications/year-three-evaluation-sra-transparency-rules/https://referral.sra.org.uk/sra/research-publications/year-three-evaluation-sra-transparency-rules/<a href="https://referral.sra.org.uk/sra/research-publications/year-three-evaluation-sra-trans

Cashflow

Many firms are focused on improving their cashflow due to the uncertain economic climate, particularly small firms and sole practitioners. Some of these cashflow improvements are being gained through having more frequent and better communication with clients – such as decreasing write-offs.

The BigHand 2024 Annual Law Firm Finance report found that firms are also focusing on improving lockup (the sum of unbilled work in progress and debtors) and adjusting billing terms. And some firms are introducing lawyer compensation for cash recovery to improve profit margins.

 $\label{thm:code} Our \ \underline{Code} \ of \ \underline{Conduct} \ for \ \underline{Firms} \ \underline{[https://referral.sra.org.uk/solicitors/standards-regulations/code-conduct-firms/]} \ includes \ your \ obligations \ that \ you:$

- 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
- identify, monitor and manage all material risks to your business, including those from your connected practices.

Regulated firms must notify us of any intention to close by completing the <u>firm closure notification</u> <u>[https://referral.sra.org.uk/solicitors/firm-based-authorisation/firm-closures/]</u>. You should also make sure that other parties



receive appropriate notice as well. You can read more about these requirements in our guidance on <u>closing down your practice</u> (https://referral.sra.org.uk/solicitors/guidance/closing-down-your-practice/).

Structural

The proportion of alternative business structure (ABS) firms has increased by 16% in the last three years (2023-24 compared to 2021-22). Turnover for ABS firms also increased by 22% in the same period.

There is a continuing increase in incorporated businesses (which made up 56% of the firms we regulate in April 2024), and the numbers of limited liability partnerships (LLPs) remains steady. However traditional partnerships are seeing a continuing decline.

Acquira found that law firm mergers and acquisitions (M&A) were predicted to increase over 2024, after activity was more subdued over 2023 due to the macroeconomic climate. And firms with external funding and a clear strategy are predicted to be in demand. Our <u>warning notice regarding law firm M&A</u>
[https://referral.sra.org.uk/solicitors/guidance/mergers-acquisitions-sales-law-firms/] sets out your obligations when selling, acquiring or merging your law firm. We are taking a particular interest in consolidating firms and are urging them to be mindful of the credentials of takeover firms, as well as of their own responsibilities.

Firms must make sure they protect the client appropriately when considering a structural change to their business. If you wish to change the legal entity of your firm, our <u>application pages</u>

[https://referral.sra.org.uk/solicitors/firm-based-authorisation/existing-firms-applications/cle/] Set out the process.

Organisational

High volume claims

Following the widely reported collapse of SSB and its impact on consumers, we have been looking into the high volume claim market as a whole.

Although still in the early stages, our investigation has already uncovered a wide range of issues in this area. These include:

- · poor accounting records
- · lack of work supervision
- · claims without merit
- · issues with client confidentiality
- evidence of 'cold calling'
- · lack of independence of expert witnesses
- inadequate after-the-event insurance cover (crucial in 'no-win, no-fee' claims)
- · growing concerns regarding third party funding models

We have <u>published a warning notice [https://referral.sra.org.uk/solicitors/guidance/marketing-public/]</u> to highlight our concerns around unsolicited approaches, cold calling and publicity materials. We have also <u>reported</u> [https://www.legalfutures.co.uk/blog/bulk-litigation-not-always-working-in-consumers-interests] on this issue more widely. Given the potential for significant consumer detriment, we are looking to move as quickly as we can to progress work in this area.

Where we find evidence that any solicitor has acted unethically or is involved in serious misconduct, we will take action. You must make sure you comply with SRA Principles and Codes of Conduct for solicitors [https://referral.sra.org.uk/solicitors/standards-regulations/code-conduct-solicitors/] and firms [https://referral.sra.org.uk/solicitors/standards-regulations/code-conduct-firms/] in this and all matters.

ESG

Clients (particularly large corporate clients) have been demanding more environmental, social and corporate governance (ESG) transparency from firms and are likely to be attracted to firms that show a strong ESG ethic.

Therefore, firms are increasingly introducing ESG initiatives. The Lawyer has found that larger firms are better placed to invest in ESG initiatives, and these have included:

- employee bonus schemes linked to travel and carbon-saving initiatives
- employee car-sharing schemes
- cutting down on plane travel by charging a 'levy' on travelling partners which gets paid into a designated carbon fund
- Friday partial shutdowns of offices to reduce energy wastage.

You must avoid <u>'greenwashing' [https://www.lawsociety.org.uk/topics/climate-change/greenwashing-what-do-you-need-to-know]</u> – ie making untrue or misleading statements regarding any ESG matters – when releasing any information. Environmental claims are governed by regulatory codes such as the <u>Competition and Markets Authority's (CMA) Green Claims Code (GCC) [https://www.gov.uk/government/publications/green-claims-code-making-environmental-claims] and the <u>Advertising Standards Authority's (ASA) CAP Code (rule 11)</u>
[https://www.asa.org.uk/type/non_broadcast/code_section/11.html#:~:text=lf%20a%20product%20has%20never,product%20in%20the%20v</u>

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The Law Society has <u>guidance on climate governance [https://www.lawsociety.org.uk/topics/climate-change/climate-risk-governance-and-greenwashing-risks]</u> to help you to advise clients on good climate risk governance, including your duty to advise under the <u>Companies Act 2006 [https://www.legislation.gov.uk/ukpga/2006/46/contents]</u>. Its guide on the <u>impact of climate change on solicitors [https://www.lawsociety.org.uk/topics/climate-change/impact-of-climate-change-on-solicitors]</u> examines how climate change risks might affect legal advice and the solicitor-client relationship as well as solicitors' professional duties.

Staff-focused changes

Firms are making some changes that will encourage legal practitioners to consider the business and how they operate within their firm, with the hope that this may improve client engagement and retention. This is following a post-pandemic difficulty with staff retention, which has persisted and could lead to a loss of clients and income.

Some firms, particularly in Europe, are making staff-focused changes, including:

- new systems that redesign promotion processes to reflect a new emphasis on business development, knowledge management, leadership, collaboration and/or cross-selling
- changing pre-retirement processes
- · providing lawyers' bonuses based on certain targets aside from their number of billable hours
- training lawyers to have a higher commercial awareness of the business.

Firms must ensure they are continuing to treat staff and clients fairly. We have laid out the ethical behaviour we expect from all those we regulate in our <u>SRA Principles [https://referral.sra.org.uk/solicitors/standards-regulations/principles/]</u>. These include that you act:

- · with honesty, integrity and in a way that encourages equality, diversity and inclusion
- in the best interests of each client.

Make sure you are aware of your <u>misconduct reporting and notification obligations</u>, [https://referral.sra.org.uk/solicitors/guidance/reporting-notification-obligations/] which includes the protections and support available for those who make reports to us.

Guidance from our <u>Professional Ethics team [https://referral.sra.org.uk/contact-us/]</u> is open to all firms, trainees and solicitors, including those working in-house.

Conclusion

It is an uncertain time in the legal sector, with new opportunities and challenges in all areas of law. Financial difficulties for many individual and business consumers have increased and most are demanding that firms are as efficient and transparent as possible. Firms have been adapting to this changing environment in creative and innovative ways, some of which could benefit solicitors and consumers alike. However, change and innovation also bring risks, and firms must ensure that both they and consumers are protected appropriately, and that they are keeping pace with regulatory obligations.

We are also responding to shifts in the legal market. <u>Our consumer protection review</u> [https://referral.sra.org.uk/sra/consultations/discussion-papers/consumer-protection-review/] was developed partly in response to more firms failing in the past few years and aims to examine our approach to protecting consumers' money that is held by firms. It focuses on how we can reduce potential harms to consumers through, for instance, improving how we identity and manage risks, and also our compensation fund arrangements for when things do go wrong.

You can keep up to date with your regulatory obligations and wider market developments by:

- <u>Subscribing to SRA Updates [https://referral.sra.org.uk/news/sra-update/]</u> and to <u>Lawtech Insight [https://referral.sra.org.uk/news/lawtech-insight/]</u>.
- Using our AML and sanctions resources [https://referral.sra.org.uk/solicitors/resources/money-laundering/].
- Regularly checking our <u>online guidance [https://referral.sra.org.uk/solicitors/guidance/]</u>.
- Contacting our <u>Professional Ethics helpline [https://referral.sra.org.uk/contact-us/]</u> for advice on complying with our Standards and Regulations.
- Contacting <u>SRA Innovate [https://referral.sra.org.uk/contact-us/]</u> for any digital or technological queries.
- Subscribing to the Legal Ombudsman's LeO News [https://www.legalombudsman.org.uk/information-centre/news/].
- Regularly reading <u>The Law Society's practice notes [https://www.lawsociety.org.uk/topics/practice-notes]</u>.

Resources

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