

# Consultation on the separate business rule and on activities within recognised bodies and RSPs

## Annex 4 - draft impact statement

1. This impact statement comprises an assessment of the proposed reforms to the separate business rule (SBR) and the extension of the activities that recognised bodies and recognised sole practitioners (RSP's) can carry out against our regulatory objectives, as also considered in light of our public sector equality duty and the better regulation principles. This statement should be read in conjunction with our market analysis which is referred to throughout.
2. We have seen the LSB's recent assessment of restrictions on separate business against the regulatory objectives and better regulation principles<sup>1</sup>. We have noted that analysis, and have quoted from it below where relevant. However, we consider that protecting and promoting the consumer interest requires that we maintain a separate business rule that, whilst not prohibiting connections with separate businesses providing non-reserved legal activities, does contain provisions that will directly reduce the risk of consumer detriment.

### Protecting and promoting public interest

3. The LSA does not require non-reserved legal activities to be regulated, nor require restrictions on separate businesses. In those circumstances, if a client chooses to instruct an alternative legal services supplier then this is not in itself detrimental to the public interest. Indeed, the changes may promote the public interest by increasing competition and access to services. Problems will arise if reducing restrictions on associations with separate businesses increases public confusion about regulation, and increases detriment to clients as a result. This is in the context of evidence suggesting that private clients already do not understand the protections available to them and may assume all services are regulated.<sup>2</sup> This would suggest that safeguards are needed to help prevent such detriment. However, it may well not be proportionate to prevent authorised persons (that are used to operating to certain ethical and professional business) from owning or being connected with separate businesses delivering non-reserved legal services when anyone else can do so.

### Supporting the constitutional principle of the rule of law

4. We do not consider that these reforms will have a significant impact on this objective – either on the independence of the SRA or of the legal professionals that we regulate. We do not consider that allowing a wider range of business structures will compromise the principle of the rule of law. Conflicts between the business interests of an authorised person and the interests of a client can occur within a regulated business as within a group or connected business structure, and clients should be dealt with by authorised persons in accordance with the regulatory principles (including acting in the best interests of the client and upholding the rule of law).

### Improving access to justice

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<sup>1</sup>[http://www.legalservicesboard.org.uk/Projects/thematic\\_review/Business\\_Ownership\\_Restrictions.htm](http://www.legalservicesboard.org.uk/Projects/thematic_review/Business_Ownership_Restrictions.htm)

<sup>2</sup> Market analysis section 4

5. By providing further business opportunities for regulated firms via separate businesses, and by making it easier for alternative legal services providers to form links with and/or become ABSs, we may increase the sustainability of regulated businesses and therefore access to justice. There is a significant level of unmet need for legal services for both private individuals and small businesses.<sup>3</sup> Allowing recognised bodies and RSPs to provide more services within their firm will also promote this objective.
6. The significant number of waivers of the separate business rule granted to ABSs shows there is a demand for different structures. However, the extent to which recognised bodies will wish to take advantage of a less restrictive rule is unclear.
7. If changes in the current rule lead clients to be confused about their regulatory position and then lead to subsequent detriment this could damage access to justice. However the current rule may prevent SRA authorised firms from owning a share in established separate business or building up the profile of a separate business to attract clients who would never have instructed the regulated business.

### **Protecting and promoting the consumer interest**

8. Removing the restrictions on links with some separate businesses could cause potential detriment to the consumer interest. It is important to consider the nature of this potential detriment. In our view this does not lie in the 'removal' of client protections such as those that currently come with LSA regulation. If our proposals are implemented, consumers will continue to have the choice, as they do now, of instructing an LSA regulated business for their non-reserved legal activity or of instructing an alternative legal services supplier. Parliament has decided that consumers should have this option. Rather, potential detriment could arise if the consumer makes that choice based on the misapprehension that the alternative service carries the same protections as an SRA regulated one, or instructs the regulated entity but is channelled to an unregulated firm and loses protections. As we have indicated in our market analysis, research shows that private clients are confused about the nature of protections and may assume that all legal services are regulated. Allowing groups to split services into separate businesses may exacerbate this problem, and in the worst case, may even have the effect of leading a client to think that she is dealing with the regulated business rather than the unregulated one. This does not mean that the client will necessarily suffer detriment in their individual case, but there will be an increased potential for detriment.
9. Clearly these potential problems need to be balanced against the potential benefits to consumers of increased access to justice (including access to holistic services via an extension of the range of activities that recognised bodies and RSPs can carry out) and reduced costs arising via competition.<sup>4</sup> According to a review of available research carried out by the LSB in 2011, overall BME individuals experienced civil justice problems more frequently than White individuals: 40.9% compared to 36.6%. The review also found that level of inaction in response was also higher with 23% of BME individuals taking no action to solve a justiciable problem, in comparison to 19% of White respondents (Pleasance et al, 2004). The incidence of employment problems differs among ethnicities, with 10.4% of Black respondents found to have experienced problems in comparison to 5.2% of White respondents. The incidence of money or debt problems was more prevalent among Black respondents (9.5%) than White respondents (6.6%) (CSJS, 2007), supported by the finding that Black individuals are more likely to be in low income households than White individuals.<sup>5</sup>

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<sup>3</sup> Market analysis section 6

<sup>4</sup> Market analysis section 6

<sup>5</sup> <https://research.legalservicesboard.org.uk/wp-content/media/2011-Consumers-legal-needs-lit-review.pdf>

10. SRA research on the experience of BME individuals using solicitors has found that:

- BME use of solicitors in the sample was less frequent than the general public (28% and 41% respectively) (SRA, 2009). The most commonly used legal services for BME people were conveyancing. The second were services related to personal injury
- Just 3% of BME people in the sample used solicitors for wills and probate services. This is low in comparison with the wider population where 14% of people use these services.
- 34% of BME people used the internet as their primary method of searching for a solicitor.
- BME people in the sample were more likely than the general community to obtain information on their solicitor's background before using them. They were also more likely to ask their friends and family for information about particular solicitors.
- BME individuals in the sample were very positive towards the idea of buying legal services from a 'non-traditional' provider such as a supermarket chain.<sup>6</sup>

11. We have considered the issue of clients with mental health problems, and in particular whether it is necessary to prohibit representation of clients before Mental Health Review Tribunals in a separate business.<sup>7</sup> However, such representation is already provided to a significant extent by the alternative legal service sector in the form of not-for-profit organisations. When solicitors provide this service for profit, this will be done through a legal aid contract which would, in effect, require them to continue to provide the services through their solicitors firm. We therefore concluded that such a prohibition was unnecessary.

12. We believe that our policy on separate businesses needs to work to minimise the risk of client confusion. That is why we are proposing not a complete abolition of the SBR - but the maintenance of a rule that includes important principles of client protection. In particular, our focus on the use of the title solicitor, and restrictions of referrals between the authorised person and the separate business where reserved services are being provided, should act to reduce these risks. The proposed rule is designed to prevent problems arising in the first place, and also provides a mechanism for protective action when things have gone wrong.

### **Promoting competition in the provision of services provided by authorised persons**

13. Removing restrictions on authorised persons from being connected with, investing in, or owning a range of businesses will reduce the risk of authorised persons being at a competitive disadvantage to firms that are providing only unregulated legal services. Allowing recognised bodies and RSP's to provide a wider range of services will also help to make those bodies more sustainable and increase competition.

14. The LSB's assessment of restrictions on separate businesses states "There is also a risk that regulations that restrict the ability of legal services providers from being connected with, investing in, or owning other businesses have the potential to drive legal services providers away from the provision of reserved legal activities in order to avoid

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<sup>6</sup> <http://www.sra.org.uk/sra/how-we-work/consumer-research/summaries/experiences-of-black-and-ethnic-minority-people-using-solicitors.page>

<sup>7</sup> Such representation is not a reserved activity.

regulation altogether. This would reduce competition in the market for reserved legal activities.”

15. We would qualify this statement by saying that such restrictions may in fact drive away legal service providers who are already regulated elsewhere (e.g. by the FCA, ICAEW etc.) from the provision of reserved legal activities in order to avoid duplicate regulation.
16. The SRA has granted a significant number of waivers to ABSs in order to avoid this latter risk.

### **Encouraging an independent, strong, diverse and effective legal profession**

17. By providing further opportunities to diversify both internally (changes to recognised bodies and RSPs) and externally via a separate business, these changes are likely to contribute in making SRA regulated bodies more sustainable and better able to compete in the market place. It could be argued that the maintenance of the current restrictive approach may place current SRA regulated providers at a disadvantage not only against ‘unregulated’ providers but as against providers authorised by other LSA approved regulators that do not operate a similar rule (although this needs to be balanced against consumer protection issues).
18. We also consider that these changes will help meet the forthcoming duty to promote growth.<sup>8</sup>
19. We have particularly considered whether there could be any negative impact on small firms, bearing in mind that BME solicitors are disproportionately represented in small solicitor practices.<sup>9</sup>
20. Our proposed restrictions will prevent firms from referring clients to a separate business in the same matter where they are providing a reserved service. We have carried out an analysis of the incidence of performing reserved and immigration work based on the RF1 (annual renewal forms) from 2013-4 to see if small firms were more likely to perform reserved services.
21. Our data shows<sup>10</sup>:
  - 96% of firms of all sizes carry out work in the reserved categories (or those likely to include reserved activities).
  - The incidence of doing conveyancing, probate and personal injury work rises with firm size.
  - The incidence of doing criminal work is lowest amongst sole practitioners and very large firms (81 plus partners) and highest amongst firms with 5-10 partners
  - The incidence of doing immigration work is highest amongst sole practitioners, 2-4 partners and firms with 26-80 partners.

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<sup>8</sup> - Department for Business Innovation and Skills (January 2014), *Draft guidance: non-economic regulators: duty to have regard to growth*, [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/274552/14-554-growth-duty-draft-guidance.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/274552/14-554-growth-duty-draft-guidance.pdf)

<sup>9</sup> 50.5% of BME solicitors work in sole practices or firms with 2 to 4 partners compared to 28.7% of White European solicitors and 30% of BME solicitors work in firms with 26 or more partners compared with 42.6% of White European solicitors.

<sup>10</sup> See Appendix A. Based on open head offices with current authorisation

22. We have then looked specifically at corporate and commercial work. This may be an area where firms will take advantage of the new provisions given the nature of the work.<sup>11</sup>
23. The Law Societies Market Assessment Report 2012-3 found that business and commercial services comprise 15% of turnover for small and medium firms. Firms undertaking corporate/commercial work in 2010/11 were, on average, significantly larger in size, whilst those generating 30% or more of their fee income from corporate/commercial work were larger still. However, sole practitioners were better represented than average amongst the sample firms generating 30% or more of their income from corporate/commercial work.<sup>12</sup>
24. There are two potential issues here that push in different directions. Firstly, if a firm is less likely to do the sort of unreserved work that will be split off into a separate business, then it will be less able to take advantage of changes in the rule. Conversely, it will face less competition from those that do so and is therefore less likely to suffer a direct impact.
25. On the whole, therefore, whilst it is not possible to identify impacts in detail, we do not consider that the evidence suggests a negative impact on small firms. It may be generally true to say that larger firms may have more opportunities to adopt different structures by virtue of their size, but that is not a valid reason to maintain restrictions on business activities – rather it is a fact of the market as a whole.

#### **Increasing public understanding of citizens' legal rights and duties**

26. In so far as the removal of restrictions on forms of business increases access to services, it would tend to increase public understanding of legal rights and duties. However, as research has shown that private law consumers<sup>13</sup> are confused about the extent to which legal services are regulated, there is a risk that these measures might increase that confusion. In our view, that risk arises primarily from the way in which the client accesses those services, and our proposed rule seeks to directly address that issue

#### **Promoting and maintaining adherence to professional principles by authorised persons**

27. One of the arguments made against removing restrictions on separate businesses is that clients will be referred to the separate business when it is not in the client's interest because there is a financial incentive to do so. We agree with the LSB's analysis here:<sup>14</sup> "However, such incentives exist regardless of whether there are restrictions on authorised persons being connected with, investing in or owning a range of businesses. If there are restrictions, authorised persons could simply offer the same services from inside the legal services body or have a referral arrangement in place with an external party."
28. In our view, the Outcomes in the Code, including in the new rule, will ensure that the professional principles are maintained. In particular, the rule contains:
  - duties only to refer when in client's interests

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<sup>11</sup> Market analysis section 3

<sup>12</sup> <http://www.lawsociety.org.uk/representation/research-trends/market-assessment-2012-13/>

<sup>13</sup> Market analysis section 4

<sup>14</sup> [http://www.legalservicesboard.org.uk/news\\_publications/LSB\\_news/PDF/2014/20141009\\_Business\\_Restrictions\\_Report.pdf](http://www.legalservicesboard.org.uk/news_publications/LSB_news/PDF/2014/20141009_Business_Restrictions_Report.pdf)

- restrictions on when clients can be referred to separate businesses
29. Of course, any rule may be breached by those who are acting dishonestly, as a number of SRA enforcement cases have shown with the current SBR<sup>15</sup>. It is important therefore that rules and mechanisms remain in place to protect clients and their assets when things go wrong.

### **Assessment against the better regulation principles**

#### *Transparent*

30. The different lists of prohibited and permitted activities in the current SBR can cause interpretation problems and are arguably insufficiently transparent. The need to grant a significant number of waivers to ABSs has also left its application in an unclear position. By removing restrictions on ownership and focussing on client protection we consider that the rule will be more transparent

#### *Accountable*

31. We consider replacing the need for waivers with a rule with clear principles will improve accountability

#### *Proportionate*

32. We consider that a restriction on taking part in separate business that impacts uniquely on SRA authorised persons may no longer be a proportionate response to the potential client detriment issue i.e. client confusion and loss of protection. Instead, a rule that focusses squarely on those issues may be a better approach.

#### *Consistent*

33. The extensive use of waivers to allow the current rule to operate and still comply with the regulatory objectives could lead to lack of consistency.

#### *Targeted*

34. We believe that that current rule does not target itself narrowly enough at the issues the SBR is there to deal with – client confusion and detriment through loss of protection - and that the replacement rule will do so more effectively.

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<sup>15</sup> See the consultation document for details



## Annex 4: Appendix A

### All open law practice head offices with a current recognition

Number of partners	Does the firm do conveyancing, probate or personal injury work?*				All open law practices	
	Yes		No		Number	%
	Number	% of firm size doing work	Number	% of firm size not doing work		
1	2,443	51%	2,379	49%	4,822	46%
2-4	2,970	70%	1,261	30%	4,231	40%
5-10	708	75%	232	25%	940	9%
11-25	238	75%	80	25%	318	3%
26-80	108	88%	15	12%	123	1%
81+	53	88%	7	12%	60	1%
no open partner posts	24	46%	28	54%	52	0%
<b>Total</b>	<b>6,544</b>	<b>62%</b>	<b>4,002</b>	<b>38%</b>	<b>10,546</b>	<b>100%</b>

\* taken from approved RF1 applications from 2013-14

Number of partners	Does the firm do any of; conveyancing, probate, personal injury, children, family matrimonial, debt collection, landlord & tenant or litigation other work?*				All open law practices	
	Yes		No		Number	%
	Number	% of firm size doing work	Number	% of firm size not doing work		
1	4,605	95%	217	5%	4,822	46%
2-4	4,077	96%	154	4%	4,231	40%
5-10	914	97%	26	3%	940	9%
11-25	312	98%	6	2%	318	3%
26-80	123	100%	0	0%	123	1%
81+	59	98%	1	2%	60	1%
no open partner posts	35	67%	17	33%	52	0%
<b>Total</b>	<b>10,125</b>	<b>96%</b>	<b>421</b>	<b>4%</b>	<b>10,546</b>	<b>100%</b>

Number of partners	Does the firm do criminal law work?*				All open law practices	
	Yes		No			
	Number	% of firm size doing work	Number	% of firm size not doing work	Number	%
1	843	17%	3,979	83%	4,822	46%
2-4	1,076	25%	3,155	75%	4,231	40%
5-10	261	28%	679	72%	940	9%
11-25	80	25%	238	75%	318	3%
26-80	28	23%	95	77%	123	1%
81+	10	17%	50	83%	60	1%
no open partner posts	7	13%	45	87%	52	0%
<b>Total</b>	<b>2,305</b>	<b>22%</b>	<b>8,241</b>	<b>78%</b>	<b>10,546</b>	<b>100%</b>

Number of partners	Does the firm do immigration work?*				All open law practices	
	Yes		No			
	Number	% of firm size doing work	Number	% of firm size not doing work	Number	%
1	785	16%	4,037	84%	4,822	46%
2-4	644	15%	3,587	85%	4,231	40%
5-10	59	6%	881	94%	940	9%
11-25	25	8%	293	92%	318	3%
26-80	20	16%	103	84%	123	1%
81+	6	10%	54	90%	60	1%
no open partner posts	0	0%	52	100%	52	0%
<b>Total</b>	<b>1,539</b>	<b>15%</b>	<b>9,007</b>	<b>85%</b>	<b>10,546</b>	<b>100%</b>