Separate Business Rule

Consultation paper

20 November 2014

Summary of Proposals

Reforming the separate business rule

1. In part A of the consultation, we are seeking views on changes to the 'separate business rule' (the 'SBR') as currently set out in Chapter 12 of the SRA Code of Conduct 2011.

2. A separate business is a business, wherever situated, that is not authorised by the SRA or any other approved regulator under the Legal Services Act, but which has certain defined links to an SRA authorised person (body or individual).[1] These links are that the SRA authorised person owns, is owned by, is connected to, or actively participates in, the separate business.

3. A separate business is not regulated by the SRA. Instead the SRA regulates the links the SRA authorised person (such as a solicitors' firm, an ABS, or an individual solicitor) has with the separate business. Under the current separate business rule in Chapter 12, SRA authorised persons are forbidden from having the defined links to certain separate businesses. Broadly, these separate businesses are those that specialise in providing non-reserved legal activities (such as drawing up wills, carrying out estate administration or providing general legal advice) or that purport to provide reserved legal services. Since a separate business is not authorised by an approved regulator, it is forbidden by the Legal Services Act from providing reserved legal services such as conveyancing, probate or litigation.

4. A separate business rule is necessary to:

    - Ensure that members of the public are not confused or misled into believing that a separate business is regulated by the SRA or another approved regulator when it is not.

    - Ensure that the protections afforded to the clients of practising lawyers are in place in relation to certain legal services (particularly reserved legal services).

    - Prevent an SRA authorised person from splitting part of a case with the separate business in such a way that the client loses statutory protection.

5. However we do not consider that these principles require us to keep the SBR in its current form. We are proposing to remove the prohibitions on links with separate businesses that carry on non-reserved legal activities and instead focus the rule on outcomes that achieve consumer protection. We are making this proposal because:

[1] Note that although we refer throughout this document to authorised persons, the provisions of the SRA Code of Conduct also cover their managers and employees.

- It will help level the playing field between traditional solicitors, ABSs and unregulated service providers.
- It will formalise what is being implemented by waivers in a significant number of cases.
- It will align the SRA to a greater extent with the approach taken by other legal services regulators and will address concerns about the SRA's restrictions on business ownership.
- It will mean SRA regulation recognises and keeps pace with changes in the market. We have carried out a market analysis as part of developing our thinking.

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6. Appropriate safeguards will be maintained (via new outcomes) to address the risk of consumer harm as the current separate business rule was originally designed to do.

7. We propose that the following principles, which broadly reflect those currently contained in the SBR applying to permitted separate businesses, should be included in our redrafted rule:

   When you own, are owned by, actively participate in or are connected with a separate business you must:

   (a) ensure, and have safeguards in place to ensure, that clients are clear about the extent to which the services that you and the separate business offer are regulated; and

   (b) not represent directly or indirectly the separate business as being regulated by the SRA or any of its activities as being carried on by an individual who is regulated by the SRA[2]; and

   (c) only refer a client to the separate business when it is in the client's best interests to do so and when the client has given informed consent to the referral and has been informed of your connection with the separate business.

8. There are important protections available to those instructing authorised persons which may be lost by a referral to a separate business. These protections include access to the Legal Ombudsman, the Compensation Fund, compulsory indemnity insurance and legal professional privilege. We have seen examples of misconduct where authorised persons have split matters involving reserved legal activities with an unregulated business to the detriment of clients. The proposed SBR therefore forbid referrals from the authorised person to the separate business in certain circumstances.

9. In particular, the draft outcomes provide that:

   (a) If you are instructed by a client in relation to a grant of probate you must not refer the client to the separate business for the administration of the estate;

[2] See also Outcome 8.1 in the SRA Code of Conduct 2011 which requires that publicity should be accurate and not misleading

(b) You must not refer a client to the separate business to provide any of the following services to that client in the same matter:

- administration services in relation to conveyancing;
- litigation support services involving legal activity; or
- pre litigation services involving legal activity in family disputes (except mediation).

10. The effect of these changes is that authorised persons will be able to set up separate businesses providing non–reserved legal services. They will be able to attract clients to those businesses in competition with providers that are not regulated under the LSA. However, authorised persons will not be able to use their reputation as a regulated entity to gain a client's instructions for a particular case, only to then hive off the case to an unregulated separate business.

11. As well as draft rules, we have prepared a series of case studies to illustrate how the proposals are intended to work in practice.

12. As part of changes to ensure that consumers are clear about the regulatory position of separate businesses, we also propose that solicitors that are on the Roll and that provide services to the public within a separate business will no longer be able to describe themselves to clients or potential clients as 'non-practising solicitors'.

Rethinking the services that can be provided by recognised bodies and recognised sole practitioners

13. Part B of the consultation is about the services that a solicitors' firm can provide to the public directly through its practice, rather than through a separate entity.

14. Under current legislation and SRA rules, there are limits on the types of activity that solicitors' firms can carry out within their practice. Our proposals extend that list of activities to include:

- Professional and specialist support services to business including human resources, recruitment, systems support, outsourcing, transcription and translating, and
- accounting services.

15. We believe that this will help solicitors' firms to become more sustainable by offering a wider range of services and providing a more level playing field with ABSs. The proposal will also allow clients to access more holistic services. We expect this particular proposal to benefit business clients in particular – bearing in mind evidence that small and medium enterprises struggle to access affordable legal services.[3]

[3] From LSB commissioned *Small Business Legal Needs Benchmarking Survey*, Pleasence and Balmer, April 2013 https://research.legalservicesboard.org.uk/wp-content/media/In-Need-of-Advice-report.pdf

Part A: Changes to the Separate Business Rule

Introduction

16. The SRA defines a separate business as a business, wherever situated, which is not any of the following: (a) an authorised body, a recognised sole practitioner or an authorised non-SRA firm, or (b) an in-house practice or practice overseas which is permitted by the SRA Practice Framework Rules 2011.

17. The separate business rule (SBR) in chapter 12 of the SRA Code of Conduct 2011 prevents both traditional solicitors and alternative business structures (ABSs) from conducting certain prohibited legal activities through a connected separate business[4]. These activities are defined in the pre-amble to the Outcomes as “mainstream" legal services which members of the public would expect to be offered as a lawyer regulated by the *SRA* or another regulator approved under the Legal Services Act 2007 (LSA).

18. Set out below are the definitions (from the SRA Handbook Glossary) of these ‘mainstream’ legal activities that are prohibited by chapter 12 and those activities that are permitted by it:

> ***“prohibited separate business activities*** *means, for the purpose of Chapter 12 of the SRA Code of Conduct:*
> *(i) the conduct of any matter which could come before a court, whether or not proceedings are started;*
> *(ii) advocacy before a court;*
> *(iii) instructing counsel in any part of the UK;*
> *(iv) immigration work;*
> *(v) any activity in relation to conveyancing, applications for probate or letters of administration, or drawing trust deeds or court documents, which is reserved to solicitors and others under the LSA;*
> *(vi) drafting wills;*
> *(vii) acting as a nominee, trustee or executor in England and Wales, except for the services of a wholly owned nominee company where such services are provided as a subsidiary but necessary part of the work of a separate business providing financial services; and*
> *(viii) providing legal advice or drafting legal documents not included in (i) to (vii) above where such activity is not provided as a subsidiary but necessary part of some other service which is one of the main services of the separate business.”*

[4] The Outcomes in Chapter 12 forbid owning, being owned by, being connected with or actively participating in the prohibited separate business

"permitted separate business *means for the purpose of Chapter 12 of the SRA Code of Conduct, a separate business offering any of the following services:*

(i) alternative dispute resolution;
(ii) financial services;
(iii) estate agency;
(iv) management consultancy;
(v) company secretarial services;
(vi) acting as a parliamentary agent;
(vii) practising as a lawyer of another jurisdiction;
(viii) acting as a bailiff;
(ix) acting as nominee, trustee or executor outside England and Wales;
(x) the services of a wholly owned nominee company in England and Wales, which is operated as a subsidiary but necessary part of the work of a separate business providing financial services;
(xi) providing legal advice or drafting legal documents not included in (i) to (x) above, where such activity is provided as a subsidiary but necessary part of some other service which is one of the main services of the separate business; and
(xii) providing any other business, advisory or agency service which could be provided through a firm or in-house practice but is not a prohibited separate business activity".

19. Any reserved legal activities included in the prohibited list would have to be authorised and regulated under the LSA in any event. However, the "prohibited separate business" activities also include non-reserved legal activities. These include instructing counsel or providing legal advice or drafting legal documents. This therefore prevents links with separate businesses that provide general legal advice or services that primarily concern legal advice (such as advice on tax law, employment law or will drafting)
.
20. There is an exception to the prohibition where the legal advice or drafting is provided as a 'subsidiary but necessary part of the work of some other service which is one of the main services of the separate business'. This would allow, for example, a link to a surveyors business that provides some legal advice on planning matters as part of its mainstream surveying services.

The previous consultation

21. In our consultation paper on multi-disciplinary practices (MDPs) issued on 7 May 2014[5], we stated that:

"Any changes made in relation to the issue of MDPs and non-reserved legal services will have a potential impact in a number of scenarios other than a 'one stop shop' MDP ABS. These will include a number of scenarios covered by the separate business rule:

[5] http://www.sra.org.uk/sra/consultations/multi-disciplinary-practices.page

- *A separate ABS as part of a wider MDP group of companies.*
- *A non-lawyer professional individual or entity owning a material interest in an ABS.*
- *An ABS actively participating in, connected with, or having an interest in a non-lawyer professional business.*
- *A solicitor or recognised body actively participating in, connected with, or having an interest in a non-lawyer professional business.*

Therefore, although the option for reform in this paper concerns MDP applicants for ABS status, any changes to rules that are ultimately agreed will have an impact on the wider SRA regulated community. For example, an individual solicitor or recognised body may be connected with a separate business providing multi-disciplinary professional services in circumstances that will not require an ABS application (e.g. a solicitor acquires a share of that separate business) but which would fall foul of the current rules. In our view it would be inappropriate to have one rule for 'one stop shop' ABSs and a more restrictive rule for separate businesses.

As a second stage of the work, we therefore intend that there should be a wider review of the separate business rule in light of the outcome of these proposals. Whilst this review would look at restrictions that could be unnecessarily holding back the market and consumer choice, we would wish to ensure that appropriate safeguards remain in place. Although the risk of consumer confusion might seem to be lower where different professional services are split into separate entities, such a split may not be apparent from the client's perspective. We will therefore want to look at the reality of different situations and maintain requirements for clients to be made clearly aware of what services they are buying and who regulates them. The SRA will want to ensure that the rules and authorisation processes will prevent the splitting of services into separate entities in order to avoid appropriate regulation. This would suggest a flexible approach to separate business provisions that is focused on the consumer rather than on business structure or on a list of activities.

What changes to the separate business rule do you think that we should consider for further consultation?"

22. The majority of those who replied to this question were in favour of changes to the SBR. Suggestions for reform from respondents to the consultation question included:

- The list of permitted and prohibited separate business activities should be removed, and instead the SRA should provide stringent rules surrounding information provided to clients and members of the public.
- There should be a re-examining of the outcomes sought by the rule and of the regulatory framework.
- Changes must ensure that entities are clear about their regulated status.
- Any changes should mirror the MDP proposals as far as possible.

23. The Law Society agreed that the SBR needs to be reviewed but considered that the implications of changing the outcomes of the rule will need to be fully analysed as this is a complex area. It had concerns that doing unreserved legal work outside of the regulatory framework could lead to results that will cause damage for consumers, and stated that client protection should be key when considering any changes. It also considered it essential to explore how any changes will affect various segments in the market and, in particular, small firms who it feels are unlikely to be able to take advantage of any changes.

The purpose of the SBR

24. The intention of the separate business prohibition is to prevent the loss of consumer and wider public interest protection resulting from SRA authorised firms hiving-off large parts of their legal services beyond the reach of regulation. Prior to the introduction of ABSs, the purpose of the rule was stated as:

> [1] *to ensure that members of the public are not confused or misled into believing that a business carried on by a solicitor, REL or RFL is regulated by the Solicitors Regulation Authority or another approved regulator when it is not*
>
> *[2] to ensure that the protections afforded to the clients of practising lawyers are in place in relation to certain mainstream legal services; and*
>
> *[3] to prevent a solicitor severing part of a case or matter in such a way that the client loses statutory protections.*"[6]

25. The first question is therefore the extent to which these purposes still apply in the changed regulatory landscape. In our view, purposes [1] and [3] remain important in the light of the regulatory objectives to protect and promote the interests of consumers and maintain adherence to professional principles.

26. We consider that purpose [2] *'to ensure that the protections afforded to the clients of practising lawyers are in place in relation to certain mainstream legal services*" is being affected by the wider opening up of the market and needs to be reviewed in so far as it relates to non-reserved legal activities.

27. The context for our views is the unfolding regulatory landscape as the LSA reforms continue to bed in. There are a number of factors involved here that are discussed in the succeeding sections of this paper.

The overall structure of legal regulation post LSA

[6] See the version of the Solicitors' Code of Conduct in force from 31/03/2009 to 05/10/2011 http://www.sra.org.uk/solicitors/change-tracker/code-of-conduct/rule21.page

28. There is no statutory requirement on the SRA to impose restrictions on connections with separate businesses. The SBR is maintained as a matter of policy. The definitions of reserved legal activities are narrow and unrealistic as the basis for the scope of regulation. A large proportion of activities by solicitors' firms are not reserved legal activities and, in the absence of the SBR, could have been carried out without any regulation. Firms could have hived off some or perhaps almost all of their legal services business into non-regulated entities, thus removing the consumer and public interest protections provided by regulation,[7] the powers of the Legal Ombudsman to provide redress to consumers, and indeed the client's entitlement to legal professional privilege. The SBR has prevented firms from doing this by, in effect, extending the scope of regulated activities to what solicitor firms actually do.

29. It has therefore been the SRA's view that the issues relating to legal businesses that are not regulated by an approved regulator under the LSA would have been best resolved as part of a comprehensive review of legal regulation. Such a review would have decided which activities required the protection of legal regulation based on a review of the public interest.

30. In our September 2013 response to the Ministry of Justice's call for evidence on the regulation of legal services in England and Wales, we stated:

    "The LSA left the pre-existing reserved legal activities in place as the basis for legal services regulation. In some ways this was an understandable decision. The LSA was a major change in the regulation of legal services and, following as it did from the OFT and Clementi reports, the strong focus of the public and political debate was competition, the economic liberalisation of the delivery of legal services and the changes to the structures for regulation felt to be necessary for that liberalisation to be carried through. Within this context there was, reviewing the debates with hindsight, a sense that a concurrent review and reform of the underpinning foundation of legal services regulation (i.e. the reserved activities) simply lay in the "too difficult" box. There is also a sense that it was considered that, in practice, they could continue to serve as the basis for the effective and broad regulation of legal services for two reasons:

    first, because there had been little evidence of commercial legal service providers seeking to provide only non-reserved activities outside of the scope of the existing regulators' grip; and

    second, because the long-existing approach to legal services regulation in England and Wales, primarily regulation "by title", had ensured that the very wide range of non-reserved legal activities being provided to consumers was regulated because all of the activities delivered by, for example, solicitors were kept within the regulatory grip of the relevant regulator.

    In practice, neither of these two assumptions has proved to be correct. First, because there has been a significant growth in the commercial provision of non-reserved legal activities by unregulated providers. For example, Employment Tribunal statistics show that from 2009/10 to 2011/12 the proportion of claimants represented by lawyers fell from 69% to 46%, by

[7] A recent example involved a firm purporting to provide conveyancing clients with "tax advice" through a Seychelles company they had set up, the intent being to reduce client remedies when (as is happening) HMRC sought the "avoided" tax from the clients.

Trade Unions from 5% to 3% whilst representation by other types of organisation/individual rose from 7% to 30%. Second, because the mechanisms used by existing regulators to maintain their wide grip on all legal activities (such as the SRA's separate business rule) are being challenged by the LSB as being inconsistent with competition and with the will of Parliament (i.e. Parliament's decision that only the reserved activities required regulation).[8]

31. The result of this was, we suggested, 'a patchwork quilt' of regulation - to which our suggested solution was a move to bring all legal activity within the scope of regulation.

32. In the event the Ministry of Justice decided to make no changes to the regulatory landscape – citing the lack of consensus from respondents and the lack of evidence of the benefits of such changes. However, it stated that the Government remained committed to reducing burdens on practitioners, promoting innovation and growth in the legal market, and reducing the barriers to entry.[9]

33. Parliament has not addressed the extent to which current non-reserved legal activities engaged in by solicitors firms should be regulated, although that was in a context of those activities being currently regulated by the SBR. The question is whether, in the current circumstances, preventing such businesses from being set up or operated is necessary in the context of the public interest as expressed in the regulatory objectives in the LSA 2007. There are strong arguments both ways.

34. The LSB position is that market factors prevail. They have pointed out that the LSA and related statutes do not require legal regulators to restrict authorised persons from investing in, owning, or having an interest in other businesses. "Parliament has had a number of opportunities to extend the scope of legal services regulation to include other activities. It has not done so".[10] On the other hand, it could be argued that the SBR provides maintenance of a long-standing consensus (since otherwise the Government could have legislated to change the position) as to the scope and clarity of regulation and redress around legal services provided by solicitor firms.

35. The SRA decided to maintain the SBR on becoming a licensing authority for ABSs in 2011 in part because of the link with the LSB's then review of reserved legal activities. However, there seems to be no current prospect of the list of reserved legal activities being extended. The Ministry of Justice's decision after the call for evidence follows an earlier decision not to accept the

[8] http://www.sra.org.uk/sra/consultations/consultation-responses/moj-call-evidence-legal-services-regulation.page

[9] https://consult.justice.gov.uk/digital-communications/legal-services-review/results/legal-services-government-response.pdf

[10] http://www.legalservicesboard.org.uk/news_publications/LSB_news/PDF/2014/20141009_Business_Restrictions_Report.pdf

LSB's recommendation that will writing should become a reserved legal activity. The Government's reasoning was that the evidence did not justify the additional regulatory burden of prescribing will writing as reserved as opposed to other measures such as voluntary regulation schemes and codes of practice.[11]

36. We therefore need to make our proposals in relation to the SBR in the context of there being no current prospects of either a review of reserved legal activities or a major reform of the regulatory landscape. However there is an increasing emphasis on deregulation and encouraging growth. The LSB is now leading work with all of the approved regulators which includes '*working together to explore legislative changes to lighten the regulatory load both within the framework of the current Legal Services Act and beyond'.*[12]

Waivers of the current rule

37. The SRA has the power to waive its rules in exceptional circumstances. Where a rule is persistently waived, this is likely to be an indication of a mismatch between SRA policy and market development.

38. In the period between March 2011[13] and 1 October 2014, the SRA granted 60 waivers of the SBR to ABS applicants.

39. The most common type of work carried out by the separate business was insurance/claims services, followed by financial services and business services.

40. We have granted these waivers having required the applicants to show that sufficient protections have been put in place to ensure that clients are not prejudiced by the arrangements – in particular that clients will not be misled as to the nature of their regulatory protections, and that there will be no 'splitting up' of reserved legal activities.

41. The conditions imposed on the licences reflect the nature of ABS applications in that the separate businesses in many cases already providing the 'prohibited' services concerned. The most common types of condition are:

    (i) The ABS is required to ensure that its branding is significantly different from that of the other entities involved so that they could be easily identifiable as separate businesses.

    (ii) The corporate member and owners of the ABS must ensure that they do not provide, or are not held out to the public as providing, any type of legal services.

[11] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/198838/Will_writing_decision_notice.pdf

[12] http://www.legalservicesboard.org.uk/news_publications/LSB_news/PDF/2014/20141010_LSB_Follows_Up_With_Regulators_On_deregulatory_activities.html

[13] When the first ABSs were authorised by the SRA

(iii) The ABS must ensure that the waiver only extends to the prohibited separate business activities that are currently undertaken by the connected businesses.

(iv) Requirements to inform the client in writing of their regulatory position if referrals are made.

42. Our data shows that, as at the end of July 2014, of the 46 ABSs then in operation that had been granted separate businesses waivers there had been only one report submitted to the SRA raising concerns in relation to a possible separate business issue. This is clearly a situation that needs to be monitored over time.

43. Waivers should be granted only in exceptional circumstances. As we have stated in our waiver policy guidance [14] '*An applicant who/which does not wish to integrate an existing "prohibited separate business" into an SRA-regulated entity may need to provide evidence that integration would give rise to significant and disproportionate cost, or to significant management or structural difficulties, so that the strict application of the provisions concerning separate businesses would effectively present an unjustifiable barrier to entry into the market and hence potentially impede the competition and consumer aspects of the regulatory objectives.'* In the cases where we have granted waivers, we were of the view that the option of either forcing the organisations to include those services within the ABS or to refuse the application was not a proportionate response and not in the interests of consumers.

44. In the present context, it would have been impractical and indeed inappropriate to insist that ABSs that have clearly arisen from existing substantial (and often regulated) businesses should be set up without connection to those existing businesses. The same is not necessarily true of current authorised firms seeking to move activity out of regulation.

45. So far the great majority of the waivers have related to new ABSs and not to recognised bodies. There have been only two waivers of the SBR granted to recognised bodies in the same period. This does not reflect a large number of refusals for recognised bodies but a difference in numbers of applications. Primarily this will be due to the nature of many ABS entities which have a group structure and already provide a number of non- lawyer services as set out above. Other possible factors may be that recognised bodies:

    - are not generally interested in setting up separate bodies on the prohibited list; and/or
    - do not consider it likely that an application would be granted or are unaware of the facility to seek a waiver and/or
    - do not understand the implications of the rule.

46. There is evidence from ABS applications received from existing recognised bodies that some firms are unaware of the prohibited list or wrongly regard it as not affecting their particular separate business arrangements.

[14] http://www.sra.org.uk/sra/how-we-work/decision-making/waivers-policy.page

47. It needs to be accepted that the context for the waivers that have been granted to ABSs is that they usually concern pre-established businesses which may be regulated elsewhere in whole or in part and for which in any event there has been no history of client detriment. One of the key arguments against the current SBR has been that - if services are already successfully delivered outside of LSA regulation – why should the fact of the business becoming linked to an SRA regulated business lead to it being prohibited? However, liberalisation of the rule will allow new businesses to be set up (with links to authorised persons) that have no track record at all, and will allow businesses that have only previously delivered services under regulation to be separated out into regulated and unregulated parts. We will return to this issue below.

Other regulators and the LSB

48. The LSB has long argued that the separate business rule is unjustified. It has argued this primarily from a market perspective, rather than from any discussion or review of which activities require regulation in the public interest. The LSB has recently released a report on business restrictions which describes the SRA's approach to separate businesses as the most restrictive of the approved regulators. The report criticises 'the confusing and seemingly arbitrary nature of what is permitted and prohibited, combined with a large number of waivers' and states that it (the LSB) considers that the SBR is unlikely to meet the regulatory objectives. The LSB does accept that the SBR addresses genuine risks which do need to be mitigated, but considers that the cost of the blanket rule in terms of prevented innovation makes it disproportionate. The report adds that the LSB supports the work of the SRA in reviewing the rule and hopes that its report assists with this exercise.[15]

49. As is set out in more detail in the LSB report, of the current approved regulators, the SRA and the Master of Faculties[16] are the only ones that impose direct restrictions on ownership or connections with separate businesses.

50. In the case of the Master of Faculties, the restriction is limited to acting as an appointed representative of a regulated financial services firm. Connections with other non LSA authorised businesses are allowed, but the regulated individual cannot use the title notary in that business and there are requirements on disclosure of the regulatory position to clients[17].

51. The Institute of Chartered Accountants In England and Wales' (ICAEW) was designated as a licensing authority for probate services in August 2014 and

[15] http://www.legalservicesboard.org.uk/news_publications/LSB_news/PDF/2014/20141009_Business_Restrictions_Report.pdf paragraph 7.18

[16] The Master of Faculties regulates notaries

[17] Master of the Faculties, *Notaries Practice Rules 2014*, http://www.facultyoffice.org.uk/wp-content/uploads/2014/09/Notaries-Practice-Rules-2014.pdf

has stated that it has received 250 expressions of interest in accreditation[18]. ICAEW's licensing regime does not include a separate business rule. Its application for approval as a licensing authority stated[19]:

"5.141. Although we may have the power as a licensing authority to impose conditions on the non-reserved activities a firm may carry out, it is not our intention do this if authorisation for these services is not required under the Act (either as a licensing authority or an approved regulator). That being so, there are no specific issues that we anticipate needing to take into account.

5.142. We agree with the LSB's guidance that the approach taken by licensing authorities in deciding whether to regulate reserved and/or non-reserved legal activities should reflect the current levels of consumer protection in the market. On this basis, we consider that to impose conditions on the non-reserved services that an authorised/licensed firm can carry out would result in an uneven playing field between regulated and unregulated firms, and would defeat the following outcome set out in LSB guidance: Outcome: different forms of commercial arrangements for ABS emerge and effective regulation provides the same levels of consumer protection for reserved and non-reserved legal activities as in the rest of the market.

5.143. Although we will not be limiting the conduct of non-reserved legal activities generally, estate administration will fall within the scope of our regulatory arrangements for accredited probate firms."

52. The ICAEW has indicated an intention to apply for approval as a licensing authority for further reserved work, including litigation.

53. The Bar Standards Board's (BSB's) new Handbook came into operation on 1 January 2014. This, combined with earlier changes following LSA implementation, provides members of the Bar with considerably enhanced flexibility in the way they can practise with non-barristers. In its application to the LSB for approval of the new Handbook, the BSB stated[20]:

"1.28 In considering the codes of other legal services regulators and how they had addressed risks, one issue we debated was whether or not to impose a separate business rule on our regulated community, along similar lines to that in the SRA's code. Our conclusion on this was again that the risks presented by a separate business (primarily, confusion on the part of the public as to whether they are dealing with a regulated service) are adequately dealt with by other rules. The SRA's rule curtails choice for consumers and service

[18] http://www.icaew.com/en/about-icaew/newsroom/press-releases/2014-press-releases/article

[19] http://www.legalservicesboard.org.uk/Projects/pdf/20121214_icaew's_probate_application.pdf

[20] http://www.legalservicesboard.org.uk/Projects/statutory_decision_making/pdf/bsb_new_handbook_application.pdf

providers and presents the regulator with a difficult boundary to patrol. We were not satisfied this was a proportionate or effective response to the underlying risk presented by separate businesses."

54. In 2014, the BSB applied further changes to its regulatory arrangements (Handbook) in order to allow entity (not ABS) regulation and stated the following[21]

Part 3 – Scope of practice rules
89. There will be no rule specifically preventing a BSB authorised entity supplying unreserved legal services in a separate business (reserved legal activities can only be provided in an entity if it is also authorised). However, all entities will be required to inform the BSB if they propose to operate a separate business so this information can be built into their overall risk profile.

55. It is important to note in this context that the individual regulation of barristers prevents them from providing legal services as practising barristers from unauthorised bodies, subject to certain exceptions. [22]

56. The Council for Licensed Conveyancers does not place restrictions on the sort of businesses its authorised individuals or entities can own, invest in, or be connected with. However, in its 2011 application for approval as a licensing authority, it confirmed that where the non-reserved legal activities closely relate to the reserved activities then it would normally expect them to be delivered through the ABS[23].

57. The Intellectual Property Regulation Board's application was approved by the LSB in December 2013. On page 14 of its application for approval, it stated[24]:

'IPreg does not restrict firms and managers from having interests in other firms providing non -reserved legal services, regardless of whether the other firm is authorised or not. We believe that consumers should be able to choose the type of legal services provider they want, provided that such choices are made on an informed basis'.

58. ILEX Professional Standards (IPS) does not impose separate business restrictions on those it authorises.

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[21] ***http://www.legalservicesboard.org.uk/Projects/statutory_decision_making/pdf/2014/20140626_1_BSB_Change_Of_Regulatory_Arrangements_Under_Schedule_4_Entity_Regulation_Application.pdf***

[22] Page 101 , BSB Handbook, *1st Edition – January 2014, Part 3, B7: Scope of practice as an employed barrister (non-authorised body)*
https://www.barstandardsboard.org.uk/media/1553795/bsb_handbook_jan_2014.pdf

[23] http://www.legalservicesboard.org.uk/what_we_do/regulation/pdf/clc_decision_notice.pdf Annex 2 paragraph 10.24

[24] http://www.legalservicesboard.org.uk/Projects/statutory_decision_making/pdf/application_(may_2013).pdf

59. The Law Society of Scotland does not have a separate business rule. Where they receive evidence that a business or individual is using a name or marketing which suggests an entitlement to practise as a solicitor where that does not apply, they pass that to the relevant authorities for prosecution of criminal offences relating to holding out etc. Any solicitor on the Roll in Scotland (whether holding a practising certificate or not and whether acting in that professional capacity or otherwise) must comply with the standards of conduct, including acting with integrity. Where a conduct complaint alleging breach of those standards is remitted to the Society by the Scottish Legal Complaints Commission, then the Society will investigate that complaint and take appropriate action.

The current list of prohibited separate businesses

60. It is important to consider the current list of prohibited separate business activities in detail in order to be aware of the consequences and potential risks of changes to the SBR. In the main, the list comprises 'legal activity' of one sort or another and can be divided into a number of areas.

61. **Reserved legal activities**: **'the conduct of any matter which could come before a court, whether or not proceedings are started; advocacy before a court; any activity in relation to conveyancing, applications for probate or letters of administration, or drawing trust deeds or court documents which is reserved to solicitors and others under the LSA'.** Clearly, the LSA requires that reserved legal activities have to be authorised in any event. If any separate body is to engage in reserved legal activities then it would need to be LSA authorised, and once authorised by another regulator would not come within the definition of separate business.[25] The SRA Practice Framework Rules 2011 also restrict the ways that solicitors, RFLs and RELs can practise – so that they could not provide reserved legal services to the public in a non-authorised body.

62. However, there may be benefits in providing clarity and for enforcement purposes of maintaining a provision in the SBR that reserved legal activities cannot be provided in a separate unregulated business. This will include the SRA being able to intervene to recover client money from that business.

63. It should be noted that the description in the current SBR in relation to litigation includes the conduct of a matter which could come before a court, whether or not proceedings are started and therefore goes rather wider than the definition of reserved legal activity. This means that, if the list is removed, pre litigation work could be moved into a separate body. This issue is considered further below.

64. **Immigration work** – the provisions of the Immigration and Asylum Act 1999 will apply to any separate business and persons carrying out work will have to be authorised by the Office of the Immigration Services Commissioner (OISC) or a designated qualifying regulator or professional body. Again, however,

[25] See the definition in paragraph 4 above.

there may be benefits in enforcement terms of maintaining this explicit provision

65. **Wills** – it is recognised that there are risks posed by unregulated will providers – see for example the LSB recommendations to the Lord Chancellor in this area[26]. However, Parliament has not included will writing in the list of reserved legal activities, and the Government specifically rejected the proposal of the LSB to include it. It is equally the case that the Office of Fair Trading research into will writing showed that there were also significant quality problems with the sample of wills drafted by solicitors. The SRA has recently released guidance as a consequence of this.[27] In those circumstances, whilst the SRA will continue to regulate will writing services provided by those it authorises, it is difficult to justify a blanket prohibition for bodies that the SRA does not authorise. Such a prohibition does, for example, prevent an ABS from being part of a group of companies where will writing services are separately provided by a bank or wealth management company. However, it also needs to be recognised that removing the prohibition will mean that firms that currently perform will writing under regulation will be able to transfer that work into an unregulated environment, and, for example, beyond the reach of the Legal Ombudsman

66. **Acting as a nominee, trustee or executor in England and Wales, except for the services of a wholly owned nominee company where such services are provided as a subsidiary but necessary part of the work of a separate business providing financial services.** The original aim of this prohibition was doubtless to prevent solicitors from hiving off the administration of estates from regulation – although the drafting goes wider than that. The position of executors and estate management needs to be carefully considered.

67. **Instructing counsel in any part of the UK.** This is part of the prohibition on mainstream legal activities by solicitors outside of regulation. However, a change in context is relevant here. It was previously the case that clients had to go through a solicitor to instruct counsel, but over the last 10 years or so these restrictions have been gradually removed, and consumers (whether individuals or entities) are now able to directly instruct any barrister that has completed the relevant two-day training course. In those circumstances, a rule that prohibits a solicitor, recognised body or ABS (or the manager of such) from being connected with a business that instructs counsel needs to be reconsidered.

68. **General non-reserved legal activity: "providing legal advice or drafting legal documents not included in (i) to (vii) above where such activity is not provided as a subsidiary but necessary part of some other service which is one of the main services of the separate business".** It is worth noting that there is no absolute ban on non-reserved legal activity in the current SBR. It is permitted within a separate business where it is provided as

[26] See the LSB's 'Sections 24 and 26 investigations: will writing, estate administration and probate activities Final report 13/02/13'

[27] http://www.sra.org.uk/sra/news/press/will-writing-guidance.page

a ‘subsidiary but necessary part’ of some other service which is one of the ‘main services of the separate business’. This means that there can be links with firms such as architects or surveyors that might need to provide a certain amount of legal advice on planning or related issues as part of their main business.

Enforcement and Client Protection Issues

69. A key consequence of allowing authorised bodies to deliver legal services activities through separate businesses is that some of these bodies will hive off large parts of their firm into such businesses. A solicitor could do this now by coming off the Roll and setting up an unregulated legal services business. More significantly, a new start-up business delivering non-reserved legal services could do so (and indeed many such businesses exist). Legal services businesses that are not subject to the jurisdiction of approved regulators range from the highly reputable (including those that are regulated elsewhere, such as by the Ministry of Justice, Financial Conduct Authority or OISC) to the new income stream for the struck-off solicitor.

70. One clear risk is that businesses intent on providing services in an unregulated structure will seek to have the part of their business that carries out reserved legal activity authorised by the SRA to gain clients via the cachet of a professional title, leading to a perception of a firm regulated by the SRA when in reality little or none of its activities are actually regulated.

71. There have been a number of serious cases before the Solicitors Disciplinary Tribunal (SDT) involving breaches of the current SBR.

Example 1

A recent SDT judgement against two partners of a solicitors firm involved conveyancing clients being advised on a stamp duty avoidance scheme through a connected separate business set up by that firm in the Seychelles which took a commission. Breaches of the SBR were found.

Example 2

‘AB Solicitors’ set up a mortgage investment scheme by which the public were invited to provide funds which the firm would lend out at high rates of interest. At a time when interest rates were fairly low, they offered returns of over 10%. The firm attracted over £10m in funds by the time concerns were raised and the SRA intervened.

The loans were not in fact secure, were made to connections of the solicitor concerned, and the solicitor was making secret profits. The loans were “administered” through a separate business ‘AB Administration Ltd’ (ABAL). According to the SDT judgement:

“The respondent and his wife were directors and shareholders of ABAL. The company was not a recognised body and was therefore a separate business.

Of the three promotional brochures before the Tribunal, the third stated that "Your loan is fully administered from start to finish by ABAL."

There was reference to ABAL paying interest "in the unlikely event of default." The latter statement was immediately below the following section: "Indemnity Insurance: We have Professional Indemnity Insurance for up to £2,000,000 on each valid claim and Directors Liability Insurance for £1,000,000. (Both subject to the payment of the appropriate excess)."

An advertisement placed by AB Solicitors referred to "All loans fully insured." In fact, the money was held by ABAL and it was not covered by indemnity insurance. The investments were in fact very risky, the transactions were not at arm's length, and the clients were not told about 3% interest being taken by the solicitors as 'an administration fee'.

Following enforcement proceedings, the SRA took control of the lending portfolio and, over several years and with much litigation, eventually recovered most of the funds.

Example 3

A solicitor 'CD' set up a complex web of companies as a vehicle for hiding funds and carrying out legal work through a separate unregulated entity, whilst failing to trade through the company purportedly authorised by the SRA. The solicitor caused losses in the order of £30m and the Compensation Fund has paid out £1.8m, with HM Insolvency Service noting losses of over £29m.

Example 4

A solicitor Mr EF set up a company that was not regulated by the SRA, to prepare wills with a view also to consumers paying large fees for "estate insurance" in anticipation of the costs of the eventual estate administration.

According to the SDT decision, complaints included:

"A complaint has been made on behalf of CW who was described by her solicitors… as a vulnerable elderly lady who had been physically and mentally frail and who had been visited at her home by a representative from [the company] as she had wished to make a minor amendment to her will to delete a small legacy. The will had inserted the Respondent and [the company] as executors and trustees with a further clause entitling them to charge 1% of the gross value of the estate, whereas the original will had nominated the residuary beneficiaries as executors.

A complaint has been made by the Reverend DB on behalf of Mrs E when she had been told that she should not appoint her son and daughter as executors but should let SPSL be the executors.

A complaint had been made by Mr SP stating that his parents had been advised against appointing his brother and himself as executors and trustees and that SPSL would act as executors themselves."

The SDT also noted:

"Moreover the complaint of Mrs F had included the assertion that the representative from [the company] had told her that 'Should the company go under, the Law Society is bound to find (underwrite) another law firm, to undertake the role of Executor on the same terms'."

Mr EF contested the intervention and the High Court noted:

"Despite its name, estate insurance involves no insurance cover of any kind. It is simply an agreement by [the company] to limit their charges for the administration to 1% of gross value or to some other low percentage in return for receiving an up-front fee…"

"The clients, therefore, are entirely dependent upon the solvency of [the company] for the return of its fee in the event that the company renounces its appointment. They cannot recover the fee, even if he or she merely decides to change executor. It goes without saying that the form of hard sell suggested in the agent's script is entirely inappropriate for any solicitor to use. In my judgement, it shows that the business of [the company] is simply a money making exercise in which the clients' interests are regarded as anything but paramount. No one could properly be advised to pay in advance for administration services without at least it being explained in terms that they should consider whether it would, in fact, effect a saving for them if their estate was small in value and that it would not be refundable, if in the future, they decided, for whatever reason, to change their personal representatives."

72. These cases and others confirm consumer risk in the context of:

    - Attempts to separate work to argue that the liability falls on an unregulated entity which may have no assets or none in the jurisdiction and/or no insurance.

    - In contrast, misleading consumers into believing that the separate business carries the same protections as the regulated law firm.

    - Unclear and probably sometimes deliberately misleading information about the entity the client is actually dealing with.

73. In some cases, the intent seems to have been to put work beyond regulation. The prohibition on having a separate business has in the past assisted with investigation and enforcement action because it makes clear that the lawyer's involvement in the other business is of legitimate concern for a regulator - both in itself but also in the use of investigative powers and potentially intervention into the unregulated entity. Indeed, action was taken in another case against a solicitor who claimed that another business providing probate services was not regulated.

74. It is important that any revised rule facilitates the SRA in taking appropriate protective and deterrent action.

Market Analysis

75. Our market analysis is attached as Annex 1. It looks at the nature of the services provided by legal suppliers that are not authorised by an approved regulator under the LSA (the 'alternative legal services market') and the consumer protections available for that work, and makes a comparison with the main areas of work covered by solicitors. It also looks at how clients choose legal services, evidence of consumer detriment and the benefits of competition. This analysis leads us to a number of initial conclusions.

76. Firstly, it is widely accepted the overall regulatory position under the LSA is complicated. This is both in terms of the numbers of different regulators involved and of the lack of a proper review of whether the list of reserved legal activities is the appropriate one (as opposed to representing a series of contingent historical developments). However, significant change to the overall regulatory architecture or to the list of reserved legal activities now seems unlikely in the short or medium term.

77. The fact that the LSA created a complicated structure does not mean that individual consumers will necessarily be confused about the regulatory position in their own particular case. Consumers can be given a clear explanation of their own position without having to understand or navigate the complex overall framework.

78. Nevertheless there is evidence that, at least as far as private client work is concerned, consumers are likely to think that all legal work is regulated when it is not and that they are unfamiliar with the remedies that might be available. There is significant potential for consumer detriment, notably in a lack of clarity as to redress and other remedies, including removal or non-availability of the powers of the Legal Ombudsman.

79. We are not aware of similar evidence in relation to corporate and business clients – but as repeat purchasers of services in a professional context one would expect many of these clients to be in a better position to make informed choices.

80. The alternative legal sector is growing and is becoming an ever more important part of how consumers access legal services. This sector is also increasingly linking up with LSA authorised providers in order to provide consumers with a range of services. These can range from the sale of or assistance with legal documents, to access to individual tailored advice from a qualified lawyer in a solicitors firm, accessible and marketed via a single online point of entry. Given that these mixed service offers are allowed under the current rules (assuming the solicitors involved do not own, are owned by, actively participate in, or are connected with the unregulated business) the current SBR would seem to be lagging behind market developments.

81. Some consumer protections exist when services and goods are purchased from this sector. The Consumer Rights Bill now in progress will extend these protections. However, one of the most significant gaps relates to the jurisdiction of the Legal Ombudsman which is restricted to authorised persons under the LSA. In our view, one measure that could improve protections available for alternative legal services would be an extension of the jurisdiction of the Legal Ombudsman to all legal services. However, the reality is that even if such a change were to be agreed in due course, it would require primary legislation, proper resourcing, and a number of years to implement, and we consider that it is not justifiable or realistic to delay the reform of the SBR in the hope of such a development.

82. Solicitors tend to focus their private client work around reserved legal activity and associated services. These services do not map against the highest level of legal need, but it does mean that the more 'serious' private client cases tend to find their way to solicitors.

83. However, solicitors also still dominate in the non-reserved private client activities of will writing and estate administration (although the latter is closely associated with the reserved legal activity of probate) and general legal advice.

84. It may be less true to say that corporate and business legal services are focussed around reserved legal services. Indeed, these providers are more likely to offer a range of traditional 'non-legal' services as well.

85. Regulatory reports received by the SRA overwhelmingly concern reserved legal activities or those activities closely associated with them.

86. This would suggest that consumer protection via an SBR should focus on those who are most vulnerable (who are likely to be private clients) and on the most serious cases (namely reserved legal activities and those activities closely associated with them).

87. Both individual consumers and small and medium enterprises can often struggle to access affordable legal services. Greater flexibility in the business models, links and investments that authorised persons can engage in may reduce costs to clients by greater competition and pooling of resources. It may also help to make existing regulated services more sustainable.

Consultation Question

1. *Do you have any comments on our conclusions from the market analysis, and any additional information or data to supply to assist that analysis?*

Our proposals for reform

88. Annex 2 contains the draft SBR to replace chapter 12 of the SRA Code of Conduct 2011. Annex 3 contains a number of case studies that illustrate our proposed approach.

Replacing the ban on links with separate businesses that provide non-reserved legal services with a rule based on outcomes that protect clients

89. In our view, the time is now right to remove prohibitions on connections with separate businesses that carry on non-reserved legal activities.

90. In reaching this conclusion we have taken into account the regulatory objectives and the better regulatory principles (as set out in the initial Impact Assessment at Annex 4) in the context of the factors outlined above, particularly:
    - the lack of impending change in the regulatory landscape;
    - the number of waivers that we have granted with the inevitable inconsistency and uncertainty this produces;
    - the desirability of aligning our rules somewhat more closely with other regulators, and of removing potential obstacles for growth and unnecessary restrictions on business structures;
    - reflecting calls to 'level the playing field' between 'traditional' solicitor firms and ABSs; and
    - the conclusions from our market analysis.

91. We consider that the correct way to consider these issues is to focus on those that we regulate – authorised persons and their managers and employees - and on the protection of the consumer. The LSA does not require non-reserved legal activity to be regulated – but there is a discretion to do so when those services are provided by authorised persons. We do not think that there needs to be a general prohibition on separate businesses providing non-reserved legal services. Instead there should be clear provisions that prevent authorised persons from operating those businesses in ways that lead to client detriment because of a confused regulatory position or because the statutory protections available to reserved legal activities are lost.

92. We need to balance any possible detriment to clients in relation to the removal of some non-reserved legal activity from SRA regulation against possible advantages in terms of increased access to services at a potentially lower cost. As we have set out in the market analysis, solicitors do not necessarily provide services in areas of most frequent legal need as far as private clients are concerned, and on the commercial side, small businesses often do not access legal services because of cost issues.

93. As we recognised when making our recent decision on MDPs, changes to what can be provided inside an SRA regulated organisation will also have consequences for the SBR. [28] However, we are not proposing that the same restrictions that apply within an MDP[29] should apply where these services are provided by non-authorised persons within a separate business. It is important to remember that a separate business will not be an SRA authorised entity,

[28] http://www.sra.org.uk/sra/news/press/board-decisions-september-2014.page

[29] For example, the requirement for suitable external regulation

that solicitors will not be able to practise within them,[30] and that the authorised body's 'connection' with the separate business may be limited to, for example, having one director, partner or member in common.

94. Therefore, our proposals are based on removing any general restrictions from performing non-reserved legal activity in a separate body. However, we are not proposing either a complete abolition of the SBR or a 'free for all'. Whilst a position of abstract principle might suggest that all regulators should take the same approach, the reality is that the SRA is not in the position of becoming an approved regulator from scratch. Although the number of ABSs is growing, the SRA regulated community provides legal services that are overwhelmingly identified with the solicitor brand and which are SRA regulated and seen by the consumers as regulated. Removing a case from SRA regulation could involve inter alia, no compulsory insurance, no access to the Compensation Fund or the Legal Ombudsman, and no requirements as to qualification, training or skill of staff.

95. We therefore propose that the following principles, which broadly reflect those currently contained in the SBR applying to permitted separate businesses, should be included in our redrafted rule:

Where you own, are owned by, actively participate in or are connected with a separate business you must:

(a) ensure, and have safeguards in place to ensure, that clients are clear about the extent to which the services that you and the separate business offer are regulated; and

(b) not represent directly or indirectly the separate business as being regulated by the SRA or any of its activities as being carried on by an individual who is regulated by the SRA[31]; and

(c) only refer a client to the separate business when it is in the client's best interests to do so and when the client has given informed consent to the referral and has been informed of your connection with the separate business.

Preventing the use of the title 'non-practising solicitor' in a separate business

96. As we are aware from cases where we have needed to take enforcement action, a client wrongly being led to believe that a business is SRA regulated can lead them into making important decisions (for example, as regards to entrusting or investing money) that can lead to serious detriment, and if there were to be no SBR at all, to lack of redress. As our market analysis shows, private clients may assume that legal work is regulated when it is not.

97. This raises the issue of the circumstances in which a solicitor can hold themselves out to the public as such, whether 'practising' or 'non- practising'.

[30] Except as in- house lawyers

[31] See also Outcome 8.1 in the SRA Code of Conduct 2011 which requires that publicity should be accurate and not misleading

98. Under Rule 1 of the SRA Practice Framework Rules 2011 (PFRs) you can only practise as a solicitor within an authorised body (including a non SRA authorised body) or as a recognised sole practitioner (or employee of one) or as an in-house solicitor.

99. Solicitors that are on the Roll are therefore able to work in a 'separate business'[32] providing legal services in only two ways:

    - as an in-house lawyer according to the terms of Rule 4 of the PFRs; or

    - as someone who is not practising as a solicitor.

100. The current PFRs still leave open the possibility of a solicitor who is on the Roll without a practising certificate providing services to the public within a separate business and describing him or herself to clients as a 'non-practising solicitor'. This term is potentially misleading if used in that context and there must be a serious risk that it implies that the person making it operates under regulated professional standards. Research has found that consumers assume anyone with a professional title is regulated, and that having a name with 'solicitor' in the title was seen as one indication of a reliable provider, and consumers had confidence in the ability of solicitors to provide legal services.[33] However, a 'non-practising solicitor' may have not kept up with the law, may have no insurance, and complaints against them will not lie to the Ombudsman. Nor will the client have any claim on the Compensation Fund or be able to claim the protection of legal professional privilege.

101. Liberalisation of the SBR may well increase the scale of this problem by removing restrictions on non-reserved legal activities that can be performed within those businesses. As part of our redraft of the SBR, we therefore propose to specify that solicitors that are on the Roll and provide services within a separate business will not be able to describe themselves to clients or potential clients as 'non-practising solicitors'.

102. We would reiterate in this context that any in-house solicitors should not provide legal services to the public, except as permitted by Rule 4 of the PFRs. Rule 9.2 of the PFR also sets out the circumstances in which conduct by a solicitor will amount to 'practising'.

Maintaining a prohibition on providing reserved services or unregulated immigration services in a separate business

103. It would be a criminal offence to carry on reserved legal activities or to provide immigration services in an unauthorised separate business[34]. However, we believe that it is important to maintain a specific prohibition on carrying out

[32] i.e. one that is not an authorised body or recognised sole practitioner etc. see paragraph 16 above)

[33] See section 4.2 of the market analysis

[34] Unless, in the case of immigration services, the business was regulated by the OISC.

these activities in the SBR for the sake of clarity and in the event of breach to facilitate enforcement by the SRA, in addition to any criminal proceedings. Such enforcement powers, for example in relation to urgent intervention, can be vital in securing client money and protecting their interests.

Preventing case splitting between the authorised person and the separate business

104. We consider that client protection requires a broader approach than simply forbidding connections with an unregulated separate business carrying on reserved legal activities or immigration services. In particular, there should be some restriction on referrals where activities that are very closely linked to reserved legal activities are split into a separate business. This conclusion ties in with our experiences in relation to breach and enforcement of the current SBR as set out above.

105. In defining how this concept should be applied, we have had regard to the guidance we have issued in our policy statement on activities that we have defined as integral to reserved legal activities in our policy statement on MDPs.[35]

106. The situations are not identical, however. Unlike an MDP, a separate business will by definition be a non SRA regulated entity. Thus, for example, our policy on MDPs prevents claims management activities being performed outside of SRA regulation within the licensed body. This is because it would be difficult to separate out these activities from reserved legal activity if performed in the same body, and also because Ministry of Justice regulation would not apply to an entity that we license. However, if the claims management business is separate and is the client's first port of call, we do not see why this business could not be connected with an authorised body or person to whom the client could be referred (with appropriate safeguards) in relation to the litigation.

107. Similar considerations apply in relation to probate services and the administration of estates. These must both be SRA regulated within an MDP. We consider that hiving off the administration of estates from probate may lead to significant loss of regulatory protections, bearing in mind that probate fraud can lead to high losses and is often difficult to detect. The counter argument is that if an organisation already provides estate administration with no evidence of detriment, why should we prevent authorised persons from having an interest in that business, or prevent that business from setting up an ABS to provide reserved legal services? Equally, if anyone can own, run or have an interest in such an unregulated business, is it potentially unfair to prevent a solicitor from doing so?

108. We think that the way to reconcile these positions lies in the manner that the client accesses the services and, in particular, the way that they find themselves instructing the separate business. Therefore, our proposed rule does not forbid SRA authorised entities from being connected with separate businesses that conduct non-reserved legal activity such as claims

[35] http://www.sra.org.uk/sra/policy/policies/multi-disciplinary-practices-sept-2014.page

management or estate administration. But that separate business has to stand on its own two feet, as do other non LSA authorised businesses. What the SRA authorised entity must not do is funnel the clients off to the non-regulated business in a way that causes them to lose regulatory protections. In order to prevent a matter where a client might reasonably expect there to be protection being split into regulated and unregulated elements, we also consider that we should look further than the definition of reserved legal activity in some circumstances.

109. Our proposed rule therefore provides that:

(a) If instructed by a client in relation to a grant of probate, you must not refer the client to a separate business for the administration of the estate.

(b) You must not refer a client to a separate business to provide any of the following services to that client in the same matter:

(i) administration services in relation to conveyancing;
(ii) litigation support services involving legal activity;
(iii) pre litigation services involving legal activity in family disputes (except mediation).

110. This means that we would, for example, allow a bank that sets up a separate ABS to continue administering estates within its banking services if we decide that there has been no evidence of consumer detriment to date. Alternatively, a solicitors' firm will able be set up or acquire ownership of or an interest in a separate business for estate administration.

111. However, the ABS or the solicitors' firm would be forbidden from referring clients that had instructed it for probate services to the separate business for the estate administration. In other words, the ABS or solicitors' firm must not 'trade off' its reputation as a SRA regulated body for probate in order to refer the clients to a business that is not under the jurisdiction of any approved regulator, and will therefore not confer the rights to recourse to the Ombudsman, legal professional privilege and other statutory protections.

112. In our view, this approach is justified in the public interest, and significantly reduces the risk of consumer confusion and detriment. There is a clear difference between a consumer choosing to instruct a business that does not claim to be regulated, and a consumer instructing a firm that promotes itself as regulated and finding that part of the service is delivered by an unregulated business. The former represents a 'level playing field', the latter does not.

113. We would however be interested in views as to whether (a) any further specific prohibitions on referrals should be included or (b) whether a more general principle would be appropriate. This might, for example, be an outcome that forbids an authorised person from dividing or allowing to be divided a client's matter between them and a separate business in a way that means that the client does not have the regulatory protections available to an authorised person.

114. In deciding whether there have been breaches of the proposed rule, we would take a purposive approach to prevent artificial arrangements whereby the authorised person ensures the client's first effective contact is with the separate body to prevent a 'referral' having taken place. We will consider what further guidance is necessary on the issue of referrals.

115. Whilst the draft outcomes do not prevent referrals from the separate business to the regulated firm, an authorised person will always have to ensure that they are acting in the client's best interests. This will mean for example, that cases should not go back and forth between regulated and unregulated services in a way that prejudices the client. Complicated divisions of work between a separate business and an authorised person may also make it difficult to comply with the outcomes relating to regulatory clarity, depending on the extent to which the client is a 'sophisticated' repeat purchaser of legal services.

Reporting and supervision

116. Our regulation would be neither proportionate or targeted if authorised persons were required to seek approval from us for any connection or association with a separate business. However, we will require the regulated community to notify us of such connections.

117. For existing firms, we are likely to require the notification on the annual return/PC renewal form rather than on creation of the business or the links with it. [36] This will assist with the collection of data and emphasises that the responsibility to comply with the rule belongs to the firm. Notification to the SRA will not amount to deemed approval by the SRA. Much will depend on how the separate business operates in practice. We will raise questions on a risk basis in relation to those separate business interests that appear to give cause for concern and may impose conditions where appropriate.

118. As with other rules in the SRA Code of Conduct, conditions may be imposed or enforcement action may be taken in a case where it comes to the SRA's attention that the outcomes of the SBR have been breached. The SRA would use sources of intelligence such as complaints or information gained on visits to firms as a trigger for action.

119. If overall regulatory income from turnover reduces as a result of non–reserved legal activity moving into separate businesses, then the necessary costs of regulation could be recouped by increasing the percentages charged on turnover and/or by increasing individual practising fees. We persistently challenge ourselves to reduce the costs of regulation. However, the reality is that we regulate entities and individuals, not volume or category of work, and therefore changes in SRA regulated turnover do not necessarily have a linear impact on those costs.

[36] The current renewal form RF1 asks for details of separate roles and businesses that will impinge on a role holder's capacity to perform their role within the firm but this question will be extended to require notification of all separate businesses

Consultation questions

2 *Do you agree that we should replace the ban on links with separate businesses that provide non-reserved legal services with a rule containing outcomes that protect clients?*

3 *Do you agree that solicitors should not be allowed to describe themselves as non-practising solicitors when providing services to clients or potential clients in a separate business?*

4 *Do you agree with our proposals to prohibit some specific referrals that split matters involving or related to reserved activity?*

5 *Should further specific bans on referrals be included or would a general outcome such as that described in paragraph 113 be more appropriate?*

6 *Do you have any other comments on draft Chapter 12 of the SRA Code of Conduct?*

7 *Do you have any comments on the case studies or any suggestions for further examples for inclusion?*

8 *Do you have any comments on our draft Impact Statement or any data or information to add?*

Part B: Activities that can be carried out within a recognised body or RSP

Issue & Background

120. The services that can be provided by a solicitors' firm within the practice itself (i.e. not as part of a separate business) are currently restricted by s9 (1A) of the Administration of Justice Act 1985 and regulations made under that section.[37] We are proposing to use the power given by s9 to provide exceptions to those restrictions in regulations by allowing solicitors to provide accounting and a broad category of business support services within a recognised body or recognised sole practitioner firm. Under our proposals, these services will continue to be regulated by the SRA.

121. In our May 2014 consultation on changes to the authorisation and supervision of MDPs we stated:

[37] These restrictions do not apply to ABSs, which are governed solely by the Legal Services Act.

" S9 (1)(A) of the Administration of Justice Act 1985 has the effect that SRA rules in relation to Recognised Bodies must '*prescribe the requirement that (subject to any exceptions provided by the rules) Recognised Bodies must not provide services other than(a) solicitor services, or (b) solicitor services and other relevant legal services'….*

……However there are currently a number of non-legal services that Recognised Bodies are allowed to carry out as exceptions provided by rules made under s9 (1) (A). In particular, Rule 13.2 of the SRA Practice Framework Rules 2011 allows Recognised Bodies to carry out activities within their firm that could be offered through a permitted separate business under chapter 12 of the Code of Conduct. These services include estate agency and management consultancy. In tandem with our review of the separate business rule, we will consider the widening of these exceptions as part of a further consultation. Our view is that s9 (1) (A) needs to be interpreted in light of the changed environment brought about by the LSA and our regulatory objectives under that Act. Given those objectives, our preliminary view is that we do not consider that it should be necessary for a Recognised Body to have to bring in non-lawyer ownership and apply to become an ABS in order to offer a wide range of multi-disciplinary professional services.

Do you agree that Recognised Bodies should be able to provide a wide range of professional services if they wish to do so? "

122. The majority of those that responded to this question on consultation, including the Law Society, support steps to allow recognised bodies to provide a wide range of professional services in house. The Sole Practitioners Group and the Law Society made reference to the need for a level playing field between traditional firms and ABSs, although the Law Society commented that '*without legislative change, there will continue to be a competitive advantage for ABSs which have the freedom to provide a wider range of activities. While becoming an ABS is an option for non-ABS firms, there are barriers for example: cost or reputational risks for those who also provide services in other jurisdictions'.*

123. The Legal Ombudsman was of the view that the legal profession should not be disadvantaged by not being able to offer wider services. However, it asserted that this must depend on the consumer demand and that, if it proceeds, there must be appropriate regulatory and client cover in place and a consideration of whether the activity is linked to their legal role or an entirely separate one.

Discussion and Proposals

124. There are two issues to resolve when considering the restrictions on recognised bodies under s9 (1A) of the Administration of Justice Act 1985 (AJA).

What are solicitor services?

125. “Solicitor services” are defined in section 9(8) of the AJA as “professional services such as are provided by individuals practising as solicitors or lawyers of other jurisdictions.”

126. Given this definition, the concept of solicitor services will change over time. As it becomes common and established practice that individuals practising as solicitors provide a certain type of service, this will become a ‘solicitor service’.

127. In our view, ‘solicitor services’ should include any ‘legal activity’ as defined in s12 LSA. A client may go to a solicitor for advice on the law in any sphere, and the solicitor’s profession has a wide range of specialisms. [38] But solicitors may also carry out a number of services which only partly involve legal activity, or perhaps do not involve legal activity at all.

128. S9 (1A) AJA is incorporated into the SRA Handbook by Rule 13.2 of the Practice Framework Rules 2011 (PFR) which provides that :

> “The business of a *recognised body* may consist only of the provision of:
> (a) professional services of the sort provided by individuals *practising* as *solicitors* and/or *lawyers* of other jurisdictions; and
> (b) professional services of the sort provided by notaries public, but only if a notary public is a *manager* or *employee* of a *recognised body*,
>
> but this does not prevent a *recognised body* providing services within Chapter 12 (separate businesses) of the *SRA Code of Conduct*, or holding an interest in a *company* which is a *separate business*.

129. Solicitors are therefore currently also able to carry out relevant permitted separate business activities in Chapter 12 within the recognised body itself.

130. The relevant list, excluding those that only apply to separate businesses, are:
a) alternative dispute resolution;
b) financial services;
c) estate agency;
d) management consultancy;
e) company secretarial services;
f) acting as a parliamentary agent;
g) practising as a lawyer of another jurisdiction;
h) acting as a bailiff.

131. It is clear that some of these activities could be regarded as solicitor services on the basis that they have been permitted for some considerable time and are activities routinely carried out by solicitors’ firms. However, whether these activities are part of ‘solicitor services’ or whether they remain as permitted exceptions to rules made under s9 (1) AJA makes no practical difference to the fact that the activities are permitted.

[38] These include insolvency services where there is an authorised Insolvency Practitioner in the firm.

What exceptions to solicitor services should recognised bodies be permitted to carry out as exceptions to rules made under s 9 (1) AJA?

132. As set out above, the current rules allow permitted separate business activities to be performed within the recognised body itself. The guidance to PFR 13.2 also allows solicitors to provide 'education and training activities' and 'authorship, journalism and publishing'.

133. The SRA's discretion under s9 (1A) AJA to allow recognised bodies to carry out work as exceptions to 'solicitor services' needs to be interpreted in light of our regulatory objectives under the LSA. We consider that, provided appropriate consumer protections are in place, extending the above list of services will allow clients to receive more holistic services (including at a better cost) and thus promote the consumer interest. It may also make recognised bodies more sustainable - thus promoting competition, access to justice, and encourage an independent strong and diverse legal profession. Our impact assessment contains further details of how these changes impact on the regulatory objectives.

134. However, there is a need to place limits on exceptions made under s9 (1A) AJA. The list of or definition of exceptions cannot be so wide as to render the restrictions in s9 (1A) meaningless. Therefore we consider that the exceptions should bear some relationship to 'solicitor services'. In particular, there should be services that consumers might reasonably expect to be delivered together with solicitor services, and where it is materially in consumers' interests for them to be so delivered. In considering this question, we have also had regard to the types of services in respect of which solicitors have declared links on their annual returns.[39]

135. Therefore, in addition to the activities already allowed within a recognised body, we would propose the following be allowed as additional exceptions under s9 (1A) AJA:

    - Professional and specialist support services to business including human resources, recruitment, systems support, outsourcing, transcription and translating, and
    - Accounting services[40]

136. We are open to suggestions of additional activities in line with the principles set out above. We would expect any list to change over time to react to changes in the market as new activities become 'solicitor services'.

137. The proposed extension of the range of services that can be performed within a recognised body will also apply to RSPs.

[39] Based on information collected on RF1 forms in 2013

[40] We have not included audit services in the list because the SRA is not able to authorise or regulate the provision of audit services.

Consultation Questions

9. *Do you agree that recognised bodies and RSPs should be allowed to provide the additional services proposed?*

10. *Are there any other services that should be allowed, bearing in mind the restrictions in s9 (1A) AJA and the regulatory objectives?*

Must all work that recognised bodies and sole practitioners carry out continue to be SRA regulated?

138. By 'SRA regulated' in this context, we mean that the rules in relation to conduct, accounts, compensation arrangements and indemnity insurance will apply to that work.

139. All work carried out within a recognised body or an RSP is SRA regulated. In an ABS, all legal activity is SRA regulated but non-legal activity is not unless subject to specific conditions. Our recent changes to the MDP policy allow non-reserved legal activity to be excluded from SRA regulated activity for an MDP ABS in certain circumstances. [41] Broadly, these circumstances are if the activity is a subsidiary and necessary part of the exercise of a non-legal profession or is performed by a non-authorised individual under suitable external regulation.

140. The table below shows these differences in regulatory framework:

[41] http://www.sra.org.uk/sra/policy/policies/multi-disciplinary-practices-sept-2014.page

Types of SRA authorised entity

1. Recognised body or recognised sole practioner (RSP)
Authorised as a recognised body or RSP and regulated as an entity by the SRA

Activity	Regulated by SRA	Individual regulation of solicitors, RELs and RFLs
Reserved legal activity and immigration	✓	✓
Non reserved legal activity	✓	✓
Non legal activity	✓	✓

2. Licenced body (ABS)
Authorised as an ABS and regulated as an entity by the SRA

Activity	Regulated by SRA	Individual regulation of solicitors, RELs and RFLs
Reserved legal activity and immigration	✓	✓
Non reserved legal activity	✓	✓
Non legal activity	✗	✓

3. Licenced body (ABS) that is an MDP
Authorised as an ABS and regulated as an entity by the SRA

Activity	Regulated by SRA	Individual regulation of solicitors, RELs and RFLs
Reserved legal activity and immigration	✓	✓
Non reserved legal activity	✓	✓
Non reserved legal activity by non-legal professionals if excluded on the terms of the licence	✗	✓
Non legal activity	✗	✓

141. It has been argued that the recent changes put MDPs at a commercial advantage compared to solicitors' firms. In our view, what gives MDPs greater access to certain client groups is the fact that they provide a range of different professional services in one place – rather than the fact that some of these services will be regulated elsewhere. Allowing solicitors' firms to provide a greater range of services within one business is a key driver for our proposals.

142. Despite this, we can see some force in an argument that recognised bodies and RSPs should be allowed the same regulatory flexibility as ABSs. In fact as our recent consultations on consumer credit and insolvency practice have shown, we are willing to consider whether areas should move out of SRA regulation where it would seem to be in the public interest for the work to fall under appropriate specialist regulators. This type of consideration would be particularly appropriate for accountancy services where various specialist regulators exist.

143. However, there are a number of counter arguments that need to be considered. Firstly, ABS regulation was set up so that only legal activity carried out by the licensed body is SRA regulated. [42] This is a feature of the nature of ABS services and their business structures. Currently, all activity carried out by a recognised body or RSB is SRA regulated whether it is legal activity or not. Some activities such as estate agency are subject to specific regulations. [43] It would be a significant shift for practitioners and clients for the SRA to move to only regulating part of a solicitor's business. It would be an even greater shift to move away from regulating all legal activity within a solicitors' firm.

144. In the case of a recognised body, and unlike an MDP, the solicitors will own and manage the body, and in that sense all work within the organisation will be performed under their supervision. Arguably the managers of a solicitors' firm should remain ultimately responsible for the quality of the legal work performed, even if it is performed by a chartered accountant or other professional.

145. A key driver for the development of the policy on MDPs has been the duplication and conflict between the provisions of different regulators of the entity. However, a solicitors' firm will not generally be regulated as an entity other than by the SRA. Taking accountancy as an example, neither ICAEW nor ACCA will regulate an entity unless at least 50% of the partners or controlling members are chartered accountants. Within a recognised body, this issue will therefore not arise. It is in fact common for individual accountants, surveyors etc. to work within all sorts of bodies that are regulated elsewhere. For example, the rules of ICAEW would allow chartered accountants to obtain a practising certificate and provide services to the public within a solicitors' firm.

146. Given the widespread recognition of the solicitor brand, major changes to what should be regulated could have implications not only for clients but for the

[42] This is subject to the SRA's right to impose conditions on non –legal activity pursuant to part 5 of the LSA.

[43] SRA Property Selling Rules 2011,

reputation of the profession itself.[44] We do not expect that all members of the profession would welcome this change. As we have stated, the issue of duplicate entity regulation does not arise in the same way with solicitors' firms, such that it may not be necessary to change the current rules in order to promote competition and secure access to justice. Solicitors' firms always have the option of becoming ABSs and there will remain differences in practice and ethos that may well be of considerable importance to practitioners and to clients. This brings into play the interests of consumers and promotion of the professional principles.

147. In light of this analysis, this consultation does not contain specific proposals to remove work carried out by recognised bodies or RSPs from SRA regulated activity. However, we think it important to test the appetite of the SRA regulated community for such a change and would be interested in views on whether this is a direction of travel which respondents consider the SRA should take in light of the regulatory objectives. If we take the view that there is the need to reduce the SRA's regulatory ambit in relation to recognised bodies and RSPs, we will run a separate consultation on the precise nature of those changes.

Consultation Question

11. Do you consider that some activity carried out by recognised bodies and RSPs should be exempted from SRA regulated activity? If so, please specify the activity or activities and provide the reasons for your views.

Consultation questions

1. Do you have any comments on our conclusions from the market analysis, and any additional information or data to supply to assist that analysis?
2. Do you agree that we should replace the ban on links with separate businesses that provide non-reserved legal services with a rule containing outcomes that protect clients?
3. Do you agree that solicitors should not be allowed to describe themselves as non-practising solicitors when providing services to clients or potential clients in a separate business?
4. Do you agree with our proposals to prohibit some specific referrals that split matters involving or related to reserved activity?
5. Should further specific bans on referrals be included or would a general outcome such as that described in paragraph 113 be more appropriate?
6. Do you have any other comments on draft Chapter 12 of the SRA Code of Conduct?

[44] See paragraph 4.2 of our market analysis

7. Do you have any comments on the case studies or any suggestions for further examples for inclusion?

8. Do you have any comments on our draft Impact Statement or any data or information to add?

9. Do you agree that recognised bodies and RSPs should be allowed to provide the additional services proposed?

10. Are there any other services that should be allowed, bearing in mind the restrictions in s9 (1A) AJA and the regulatory objectives?

11. Do you consider that some activity carried out by recognised bodies and RSPs should be exempted from SRA regulated activity? If so, please specify the activity or activities and provide the reasons for your views.

How to respond to this consultation

Online

Use our online consultation questionnaire to compose and submit your response. (You can save a partial response online and complete it later.)

Email

Please send your response to consultation@sra.org.uk. You can download and attach a Consultation questionnaire.

Please ensure that

- you add the title "Separate business rule" in the subject field,
- you identify yourself and state on whose behalf you are responding (unless you are responding anonymously),
- you attach a completed About You form,
- if you wish us to treat any part or aspect of your response as confidential, you state this clearly.

If it is not possible to email your response, hard-copy responses may be sent instead to

Solicitors Regulation Authority
Separate Business Rule consultation
Policy and Strategy Unit
The Cube
199 Wharfside Street
Birmingham
B1 1RN

Deadline

Please send your response by **12 February 2015.**

Confidentiality

A list of respondents and responses may be published by the SRA after the closing date. Please express clearly if you do not wish your name and/or response to be published.

Though we may not publish all individual responses, it is SRA policy to comply with all Freedom of Information requests.