THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

28 August 2009

Our ref: ICAEW REP 91/09

Your ref:

Ms Margaret Hope
Solicitors Regulation Authority
Ipsley Court
Redditch
Worcs
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By email

Dear Ms Hope

Legal Services Act – New Forms of Practice and Regulation
Consultation paper 18

The Institute of Chartered Accountants in England and Wales (the ICAEW) welcomes the opportunity to comment on the Consultation Paper "Legal Services Act –New Forms of Practice and Regulation" published by the Solicitors Regulation Authority (SRA) in June 2009.

We believe the issues raised in the Consultation Paper and these responses demonstrate the need for dialogue. We welcome the opportunity to take this forward with the SRA.

The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council (FRC). The Institute is also a Designated Professional Body under Part XX of the Financial Services and Markets Act 2000 and a Recognised Professional Body under the Insolvency Act 1986. In all three roles we undertake statutorily derived registration and monitoring functions, under the oversight of a government or quasi-government body. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 132,000 members in more than 165 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained.

MAJOR POINTS

Introduction and offer of support

The Institute has

- an overriding duty to act the public interest; and
- skills as a regulator of firms of all sizes
- long experience of regulating both individuals and firms in a wide range of forms of practice.

The Institute offers its skill, experience and assistance to the SRA.

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Regulation and structures

In this response we have identified a number of regulatory issues, whether of conflict or overlap, which we believe merit further analysis. In our response to paragraph L we have advocated the use of memoranda of understanding as a potential solution.

We are concerned that there should be a level playing field, particularly for those entities already regulated by others.

Fundamental to this exercise is a considered review of potential ABS models which either will develop, or alternatively should be allowed to develop, free of regulatory or professional restraints.

The Institute is concerned that current or proposed regulatory arrangements (of both the SRA and other regulators such as the Financial Services Authority or Financial Reporting Council) will inevitably influence the formation and operation of ABS. This will encourage workaround arrangements and thereby distort true competitive forces and fail to serve consumer interest.

The legal services market is already shifting in key areas such as legal aid and pro bono work, and the impact of these areas on a proposed regulatory framework requires urgent assessment.

ABS modelling

The models of potential ABS circulating to date are incomplete. The Institute has set out three further models in the Appendix to this response and subjected them to an initial regulatory and professional "stress test" which reveals issues for urgent consideration. There are other models and indeed other regulatory bodies could be profitably invited to do a similar exercise.

Restrictions

Current restrictive practices, and issues raised by limitations on costs recovery and professional privilege must be examined for relevance and potential impact. Our views are set out in paragraph 2 (iv) of this response

Our main focus is that we want to see the SRA freeing up access to legal services and enhancing consumer choice. Our comments in this response should be read in that light.

Yours sincerely

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THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

ICAEW REPRESENTATION

RESPONSES TO SPECIFIC QUESTIONS/POINTS

1. A vision for the regulation of legal services

Our comments are set out in the Major Points section of this response.

2. Starting principles for the regulation of ABSs

Discussion points

i. Do you agree with our starting proposition set out in paragraph 2.5?

ii. If not, please explain what additional restrictions you believe may be necessary to address what risks.

iii. Do you agree that we should try to provide a regulatory framework for ABSs as soon as possible? Please give reasons for your answer.

2 i do you agree with our starting proposition set out in paragraph 2.5?

The starting proposition is incomplete as it stands. The model in place for LDPs does not countenance the full range of ABS models available or the existing regulatory arrangements that will affect them.

The thrust and intention of the Legal Services Act (the Act) was to promote choice and protection for consumers. The high street provision of legal services is in difficulty. However going forward it is important to ensure consumer choice is enhanced and at the very least no less than actually exists at the moment.

The SRA should establish a level playing field for new as well as existing entrants, and provide them with a proportionate system of regulation to develop the choice and protection that Clementi hoped.

BERR Principles of Good Regulation require regulators to be mindful of “unintended consequences” in one area by regulating in another. The Institute is concerned that current regulatory arrangements will inevitably influence the formation and operation of ABS. This will encourage workaround arrangements and distort true competitive forces, contrary to the spirit of the Act

ii. If not, please explain what additional restrictions you believe may be necessary to address what risks

Until the points raised in this response. on regulation and restrictions on competition have been further assessed, we do not wish to set our any comments on additional risk This would be premature.

iii. Do you agree that we should try to provide a regulatory framework for ABSs as soon as possible? Please give reasons for your answer.

We believe the more important objective is to get the regulatory framework right on day one. The SRA should not rush into establishing a framework that is wrong and restrictive in effect. It is in the consumer interest that ABS structures are allowed to form freely and fairly, and regulation responds to market developments, rather than the reverse.

We recommend (to the extent not already done so) the SRA evaluates

- unintended regulatory consequences and examines what is actually happening in the market now (demonstrated currently by the changes in the provision of pro bono and legally funded work),
- the potential range of ABS models and the implications arising from them by consulting with other relevant regulators of professions whose members might want to form an ABS

Within these parameters, delay should be avoided to the extent possible.

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iv. Do you agree with the principle that the ABS regime should provide to the public the same consumer protections provided by the current regulatory framework?

It is important to ensure that the words "consumer protections" are not interpreted to justify the continuation of potentially restrictive rules and restrictions which do not in fact protect the interests of consumers. The question is not whether existing arrangements are operating efficiently, but whether existing arrangements are effective, or indeed unnecessary to the extent that they are protective of solicitors only.

Nevertheless, rules and principles already exist that will have a direct impact on the potential form of ABS and their attractiveness or lack of attractiveness to certain businesses and professionals. These are not" consumer protections" in the true sense of the word but are arrangements which have served their time and are anti competitive. To allow "the same" protections to continue when they are not true consumer protections will distort ABS implementation

We note that the SRA has set out its interpretation of starting principles. One of those is "the avoidance of detailed rules prescribing or proscribing particular business models", which we welcome as a general philosophy assuming these protections are properly categorised and evaluated.

Protections we have identified impacting directly the potential provision of legal services include

- restrictions on rights of solicitors to provide services direct to clients other than within a solicitors practice. For example a solicitor practising in an accountancy firm cannot be held out to clients as a solicitor and must be described as a "lawyer" when providing legal services to clients

- restrictions preventing cost recovery following the Agassi v Robinson case (2004 EWCA Civ 1518) in which the taxpayer was unable (despite the sympathy of the court) to recover accountants costs, but would have been entitled to recover had the same work been undertaken by a solicitor. This leads to artificial arrangements where accountants instruct solicitors to instruct the barrister purely as an administrative exercise to protect cost recovery – this cannot be in the consumer interest, and is unnecessary

- complications arising from the rules on professional privilege. For example members of the ABS may undertake taxation advice for clients yet one (a solicitor) will benefit from professional privilege and one (an accountant) will not even though the work undertaken is identical. A review of this area is overdue.

v. If you disagree, please give reasons explaining which consumer protections you consider necessary for ABSs.

Consumer protections should relate to the service being provided and by whom, rather than the form of practice from which it is being provided. Provided there is clarity over the way in which firms as well as individuals are regulated, unnecessary restrictions should be avoided.

Our preliminary thoughts are set out in our response to the previous question.

3. What is an ABS?

Discussion points

vi. Do you think that there are other broad models than the three set out here?

The three broad models are:

Firms providing solicitor type services only, but with one or more non-lawyer manager;
Ring fenced legal services entities with full or partial external ownership; and
MDPs.

vii. Do you think there are other examples of models to be added to those in Appendix A?

viii. Do you agree that the regulatory regime should focus upon outcomes and supervision, rather than attempting to restrict business models?

vi. Do you think that there are other broad models than the three set out here?

Yes. There are other broad models.

We consider that the model of an MDP given in the consultation paper is limited and does not take account models where the entity is dominated by different (i.e. non legal) professions.

For example an accountancy firm with c 50 partners could join forces with a niche firm of solicitors with c 5 partners. This would be an “accountancy led ABS”. It has little in common with the MDP model identified with a variety of professionals.

Accounting services include such activities as taxation, company law and business recovery where there is a significant legal element, and other business services with a legal component such as financial reporting, audit and investment business which require a detailed legal knowledge.

The Institute is happy to discuss and examine potential ABS structures with the SRA and we include three potential models in the Appendix to this response

vii. Do you think there are other examples of models to be added to those in Appendix A?

Yes. We have highlighted the accountancy led ABS earlier. In our Appendix we have “stress tested” ABS models and made conclusions as appropriate. We suggest that other relevant professions could be invited to do likewise.

viii. Do you agree that the regulatory regime should focus upon outcomes and supervision, rather than attempting to restrict business models?

As broad principle yes, although as stated above ABS structures should be allowed to form freely and fairly. However the Institute is concerned that current regulatory arrangements will inevitably influence the formation and operation of ABS. This will encourage workaround arrangements and distort true competitive forces. We have set out our proposals to assess regulatory impact earlier in this response.

4. What is the SRA's broad approach to the regulation of ABSs?

Discussion points

ix. Does this seem the right approach to the prompt introduction of ABSs?

We cannot say that this is the right approach. At this stage we do not know what all the potential ABS models are, and what existing regulatory regimes will be impinged.

In simple terms the knowledge base is still incomplete.

Dialogues with other regulators whose members may wish to participate in an ABS but who are not themselves approved legal services regulators will assist. We have the following specific comments on your "core requirements" as set out at paragraph 4.3 of the consultation paper

Bullet 1

- We agree that firms should be recognised by a recognised legal service regulatory body before providing regulated legal services but this should not apply to all legal services. Most accountancy practices routinely provide unreserved legal services which for the purpose of accountancy regulation are included within the definition of accountancy practice.
- This provision would effectively prevent any existing accountancy practice from becoming an SRA licensed ABS, even where the existing unreserved legal services are provided under the professional oversight of a body like the ICAEW

Bullet 3

- We agree that all non lawyer managers should be subject to appropriate fit and proper tests, but these should be automatic for all those members of professional bodies with equivalently high integrity standards to those of the SRA

Bullet 4

- We cannot believe it necessary in the public interest to apply all these SRA requirements across a firm which has a majority of managers or owners who are members of an equivalent professional body. This would lead to additional dual regulation which would distort competitive effectiveness

Bullet 5

- We agree that the SRA should have the ability to de-licence any form for any reason in the public interest. However such decisions should be made (where relevant) in discussion with other professional bodies or regulators. The behaviour of individual managers and the firm as a whole should be judged in accordance with the requirements of the relevant professional body

Bullet 6

- We do not agree to this proposition where the "solicitor services" are also accountancy services provided by a professional accountant as part of their normal business activities as outlined above

5. What issues need further consideration?

A. Reserved/non-reserved legal activities

We note that the SRA does not propose to regulate activities that are clearly not legal services, and the application of the Code of Conduct and other rules will need some form of limitation in practice. However the views expressed on reserved and non reserved legal activities are unclear which hinders our response.

The consultation paper does not consider the impact on existing *non* law firms (such as accountants), who are already providing non reserved legal services which are already regulated elsewhere

It is critical that existing suppliers of non reserved services which are regulated elsewhere are not placed in a worse position going forward. The Consultation paper observations are obscure and we are happy to discuss them.

B. Is there anybody who should not be able to be licensed or own an ABS?

We assume that criminals and those involved in previous business misconduct will be excluded.

C. How will we take into account the object of improving access to justice?

The Financial Reporting Council has already developed an annual reporting process which the SRA could examine. This has a methodology which measures and demonstrates access levels on a year by year basis.

D. Equality and diversity within the legal profession

We have already submitted to the LSB that in our view, at the firm level, a well planned and regulated ABS framework is likely to benefit the consumer of legal services as other competent (and diverse) providers can participate.

This will encourage diversity as a variety of business models can enter the market. At the individual level, the Act cannot of itself change attitudes that may have prevented diversity of opportunity, but it can act as a catalyst, as new providers of legal services bring new ideas into play. However, bureaucratic attempts to enforce diversity targets are likely to be counter productive.

E. The fit and proper test for external owners

We have no particular comments to add at this stage on this test

F. Adverse interests

Conflicts of interest require close attention and may need specific dialogue between regulators

G. The role of managers, HOLPs and HOFAs

We agree with the SRA that it is not necessary in all cases to have a majority of lawyer managers as this would completely outlaw the possibility of the existence of ABS with a majority of other equally well regulated professionals.

This would radically reduce the possibility of innovative models coming forward for no good reason with, in our view, a consequent disbenefit to the consumers of legal services.

We believe that character and suitability tests for non lawyer managers who are acting as a HoLP or a HoFA should be no less rigorous than for a lawyer, but that they should be equivalent, rather

than the same. We believe that Institute members would satisfy an "equivalence" test and are happy to consider this specifically with the SRA

H. Multidisciplinary practices (MDPs): Different service combinations

We disagree with the comment that audit and legal work are incompatible within the same organisation and we are happy to work through this specifically with the SRA.

The Institute already regulates organisations that provide such services and it is necessary to evaluate the relevant service offered to the relevant client. The ultimate duties of confidentiality, and to act as a servant of the court or in the public interest, are similar. Appropriate professional requirements, conflict and practice management rules cover the position successfully.

I. Insurance requirements

Please note our comments below.

J. Compensation fund requirements

We agree with the SRA that this area needs further work and we are pleased with the specific request for early views.

We have not experienced significant problems with clients' money but we are aware that other professions are in a different position. We would suggest that a way of dealing with this issue, in the absence of a compensation scheme which in reality makes the good pay for the bad, is to require higher PII for those firms holding clients' money or the holding of a bond that pays out in the event of a defalcation.

We suggest that in so far as possible under the statutory limitations, both indemnification and compensation arrangements, and complaints handling arrangements, should follow the existing arrangements for the majority of the controllers or managers for the ABS, where these exist in a formal regulatory or professional format.

Thus these should follow FSA requirements for an IFA led ABS, and professional requirements for an accountant-led ABS.

However, as the FSA has already found, it is not possible to require the insurance market to insure entities that it regards as a risk. While the assigned risk pool (ARP) concept works, it could be overwhelmed in the case of a market crash or some other systemic failure, as would a mutual which from a risk perspective should have reinsured itself in the market.

But it should be noted that the ARP operated by the Institute has never, in all its years of existence, had more than 15 firms in it, from a potential population of accountancy firms of well over 11,000. Our experience is that if a firm enters into a sensible discussion with a broker and insurer, then insurance is generally forthcoming. Premiums tend to be driven by claims history, rather than any perception of one operating model is better than another}

K. Clarity for the consumer (descriptions)

Consumer clarity is essential. Some entities will provide reserved legal services, some non reserved, and some both depending on their business model.

Consumers are likely to have negligible practical interest in what they may perceive as a theoretical distinction between reserved and non reserved legal services. A consumer must be able to identify a regulator and a complaints mechanism.

Existing restrictions of use of the word “solicitor” also require examination and are considered elsewhere in this response.

L. Conflict between different regulators

Tax work is a key element of many accountants’ practices as an unregulated legal service. It is already subject to regulation by the Institute and a cogent example of an overlapping work area that demonstrates the need for regulatory dialogue to examine conflicts.

-Institute position

The ICAEW is very willing to discuss its own professional requirements, with a view to removing unnecessarily duplicated or conflicting requirements.

The impact of dual regulation could be considerably mitigated by agreement and common working between the various regulatory authorities. Notwithstanding the detail of the statutory requirements of the Legal Services Act, we see no reason why one regulator might not delegate part of its regulatory remit to another, by non-statutory agreement. Without such agreements, we cannot see how a number of the regulatory objectives of the Act can be fully achieved.

In an ideal world, all firms subject to diverse regulatory requirements would have a single ‘whole-firm’ regulator, usually the regulator who represents a majority of the partners, or work, of the firm. This regulator would deal with such issues as are most appropriately dealt with across the firm, such as systems and client service requirements (including anti-money laundering compliance and reporting requirements) as well as charging issues, timely responses to client needs, and requirements for governance and control of the firm. Apart from these whole-firm matters, each regulatory authority would deal with matters.

We believe that joint inspections may be one solution where such crossovers necessarily exist, for example due to work types such as taxation.

- Further discussion

As stated previously in this response, more models exist and an ABS may not be lawyer dominated. Stress testing potential ABS models at an early stage could identify potential regulatory conflict before it happens

M. Special and low risk bodies

We are not aware of any particular risks to consumers of legal services provided by trade unions, non-profit making bodies, or legal practices provided by firms with a large majority of lawyers acting as owners or managers.

it would seem sensible if the SRA engaged directly with them, to establish if any more work is needed in this area.

If a more relaxed regime is be extended to ABS with a large majority of lawyers, we consider that a similar approach should apply in cases where other appropriate professionals or regulated persons, such as professional accountants hold a majority and the level of reserved legal services is low in relation to the size of the firm.

This could be similar to the Designated Professional Body arrangements of Part XX of the Financial Services and Markets Act 2000, which allows firms of accountants to undertake a limited range of investment business.

We are happy to debate this further with the SRA

N. Other perceived risks?

We have no specific views to add at this stage on the risks of external financial investment but are happy to consider it further.

APPENDIX

ABS Case Studies

Example 1

3 sole practitioners, a solicitor, a chartered accountant (FCA) and an IFA wish to join into partnership, for mutual support, client service and overhead savings.

Hub and Spoke

The three individuals set up a holding company in which they each take shares in exchange for ownership of their respective practices. These new subsidiaries are regulated in much the same way as previously – the IFA by the FSA, the FCA by the ICAEW and the solicitor by the SRA. The FCA will continue to require a Practising Certificate and be subject to ICAEW Practice Assurance requirements (including routine monitoring visits on a rolling basis, to check that appropriate procedures are followed). The solicitor's practice converts to an ABS, under the ownership of the holding company. It is licensed by the SRA, and complies with their requirements as if it was still a standard legal practice.

With this model each subsidiary will need to have their own procedures, including accounts engagement letters, complaints, regulatory and liability considerations. Clients may be confused, particularly with the differences in engagement letters and in the issue of which entity they are dealing with at any one time. This could confuse and complicate complaints management. Many of the hoped for administrative efficiencies will be lost, for these reasons.

Single ABS Licensed by SRA

Alternatively, the three individuals could set up a single entity, jointly owned, and licensed by the SRA as an ABS. This would considerably simplify the administrative procedures, and clients would have a single entity to deal with.

However, the regulatory issues, certainly so far as the FCA was concerned, would be considerably complicated. The FCA will continue to require a Practising Certificate from the ICAEW and be subject to ICAEW Practice Assurance requirements. Complaints about the work of the FCA would have to be dealt with twice, once according to his own professional affiliation and once under the remit of the OLC.

The three individuals could considerably simplify their regulatory and compliance costs were the FCA to resign his membership of the ICAEW and continue in practice as an unqualified accountant acting within the ABS, under the sole regulatory remit of the SRA. However, the SRA does not have experience of the regulation or disciplinary oversight of accountancy work, and it is never likely to be its main focus. There is therefore likely to be a weakening of the overall oversight of the services afforded to the clients of the former FCA. Not only this, but other users of client financial statements and other information produced or supported by the work of the former FCA, such as creditors and other trading partners, HMRC and the banks and other lenders, would have their assurance of the output of the accountant weakened. Both outcomes are counter-intuitive to the overall aim of the Act.

Example 2

2 partner firm of solicitors is in financial difficulty and is bought by a local 8 partner firm of Chartered Accountants

Accountancy firm purchases the Solicitors Practice, and maintains it as an ABS Subsidiary

In this scenario the regulatory complications would be kept to a minimum, and both solicitors and accountants could continue their business activities as before. However, administrative efficiencies would be reduced, as with the hub and spoke example above.

Accountancy firm takes the 2 solicitors into partnership as an ABS licensed by the SRA

For the accountancy practice to take the two solicitors into partnership, the whole firm would need to be licensed as an ABS. This would mean that the two solicitors could continue to undertake reserved legal services, but tax and general business advice carried out by the eight chartered accountants would often come within the definition of unreserved legal services, and would thus come under the oversight of the HoLP, and the full regulatory remit of the SRA. We assume that in this scenario, the two solicitors could continue to describe themselves as such, though this is not currently clear to us. This represents unnecessary dual regulation of the accountancy services that have been provided by the chartered accountants for many years. In addition, all the services provided by the whole practice would be subject to complaints being referred to the Office for Legal Complaints, even though client complaints against the services of chartered accountancy practices are very much fewer in number and have not raised the concerns that complaints against solicitors' practices have.

As the firm still has a majority of partners who are members of the ICAEW, and provides accountancy services, they cannot resign from the Institute's whole-firm oversight – including practice review and anti money laundering supervision.

If the firm wishes to use the description 'chartered accountants' or is a registered auditor, the solicitors will need to become associate members of the Institute, and become bound by the Institute's Ethical Code and disciplinary oversight. If the accountancy firm is a registered auditor, further complications will arise, due to the impact of audit independence requirements, and other whole-firm audit regulations.

Accountancy firm takes the 2 solicitors into partnership without becoming an ABS

Alternatively, the two solicitors could resign their status, and act as partners in the firm as non-solicitor lawyers. The restriction on their designation is not due to any legislative provisions, but due to restrictive Law Society Rules. The lawyers would therefore act without the oversight of the SRA or any other legal services regulator. This may be adequate to the needs of clients, as the firm will still be subject to the Institute's oversight, but will change the ethical and regulatory oversight of the work of the lawyers.

Under the provisions of the Legal Services Act, the two lawyers would have to cease the provision of any reserved legal services, so that the whole firm provides unreserved legal services only. This would represent a reduction in the provision of reserved legal services, again, counter to the overall aim of the Act.

Example 3

Large accountancy practice with a national and international reputation for corporate finance, tax and general business advisory services finds itself in direct competition with large law firms, which have developed their services in these areas having been able to attract top class accountants with the offer of full partnership

In the future, top law firms will be able to offer partnership status to world class accountants (who are not delivering audit or another reserved accountancy services. The law firm can then provide a full multi-disciplinary practice, without having to undergo dual regulation, except to the extent that the chartered accountants involved remain under the disciplinary oversight of the ICAEW.

Top accountancy firms, in contrast, will not be able to offer full partnership status to solicitors (acting for clients, as such) without forming an ABS with very considerable cost implications arising from dual regulation. In practice, the accountancy firm is more likely to form a separate ABS law firm, as a subsidiary. This will have similar costs arising from the administrative complexities, and potential confusion, as arises in the case of smaller firms. Individual world class accountancy advisers may transfer to law firms, in order to be able to work in closer partnership with world class lawyers, and with simpler relationships with clients requiring the services of both a lawyer and an accountant.

This lack of a level competitive field will necessarily damage the market in the provision of legal services, with an unfair advantage being available to large law firms over large accountancy firms. This will tend to prejudice the interests of clients, whose decision making will be influenced by factors other than the most efficient and effective provision of services. Over time, this effect may also reduce the diversity of the provision of legal services, if the provision of general professional services from accountancy firms becomes uneconomic.

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