



## Regulatory Reform Programme

### Improving Regulation: proportionate and targeted measures

ICAEW welcomes the opportunity to comment on the consultation paper, *Regulatory Reform Programme. Improving Regulation; proportionate and targeted measures*, published by the Solicitors Regulation Authority (SRA) on 16 April 2015, a copy of which is available from this [link](#).

This ICAEW response of 18 June 2015 reflects consultation with the Business Law Committee which includes representatives from public practice and the business community, and consultation with the ICAEW Solicitors Group. The Solicitors Group Committee is made up of experts in solicitors' accounts and financial management, from accountancy and legal practices.

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## MAJOR POINTS

1. We welcome the aim of the SRA to reduce unnecessary burdens and costs on the firms it regulates by proportionate and targeted regulation.
2. We do, however, have some reservations about the proposed changes to the client money rules (questions 10-12 inclusive). We understand that the Legal Services Board (LSB) is looking into this issue and we would urge you to liaise with the LSB on this matter.

## RESPONSES TO SPECIFIC QUESTIONS

### Simplifying compliance office approval for small firms (1-4 managers)

**Q1: Do you agree with the SRA's proposal to introduce deemed approval for the Compliance Officer for Legal Practice (COLP) and the Compliance Officer for Finance and Administration (COFA) roles for sole practitioners and 1- 4 manager firms?**

3. We support this proposal which removes an administrative and time delay burden for many small firms.
4. We note the concerns of the SRA with the regard to the risk of the appointment of an inappropriately experienced individual as COLP/COFA. This risk is mitigated by the SRA retaining the right to review further an appointment if there are any concerns over the experience or appropriateness of the person appointed. Our view is that for most small firms, this safeguard will be sufficient, provided that the SRA remains alert to possible abuse.
5. We note, however, that whilst this change would result in an easing of regulation for "small" firms some firms may be very large in fee income / activity terms but are simply run and owned by 1-4 managers/partners. We suggest that the SRA imposes an upper turnover / fee income limit to remove such firms from eligibility for the exemption. Firms with a high turnover but a small management team may be particularly vulnerable to abuse, and so a higher level of status and experience for individuals appointed as a COLP / COFA for such firms is appropriate.

**Q2: Do you believe that deemed approval of COLPs/COFAs should be limited to certain types of firms? If so, which firms and why?**

6. We do not believe that deemed approval should be limited to certain types of firms. In particular we would suggest that there is merit in adopting the same approach for ABSs and recognised bodies.
7. The SRA's current approval system regarding the formation, registration and ownership of all firms is robust and we are of the view, therefore, that there are already sufficient safeguards in place to ensure that only appropriately qualified individuals are owners and managers. In the case of ABSs, it seems entirely possible that these "newer" types of firms might already employ appropriately qualified or experienced people in contrast to a "traditional" firm - particularly so perhaps in the case of the COFA role. It therefore seems unfair to exclude such firms (particularly small firms) from these arrangements. By retaining the right to query any appointment to a compliance role we believe this provides the SRA with sufficient safeguards to enable potentially inappropriate appointments to be reviewed and if necessary overturned.

**Q3: Do you believe there are certain criteria or characteristics in a prospective COLP/COFA which should require us to assess their application nonetheless? If so, which criteria or characteristics and why?**

8. We confine our comments to the role of the COFA, as that is the role with which we are most familiar.

9. We suggest that the following information should be obtained in order to assess an individual's suitability as a COFA:

- a) Professional finance qualifications held eg AAT, ACCA, FCA;
- b) Membership of any relevant professional bodies e.g. ILFM;
- c) Summary of practical experience in a finance capacity in or outside the legal sector; and
- d) Details of any regulatory adverse findings against them during the last 20 years e.g. by a professional body; and
- e) A satisfactory Criminal Record check.

In each case an adverse response or an inadequate response, in the opinion of the reviewer, should result in further investigation before the individual can be assessed as suitable for the role.

10. In addition the firm should provide details of the annual training the individual will be undertaking to remain up to date in their role as COFA.

#### **Simplify candidate declaration and notification processes**

**Q4: Do you have any views on the SRA's proposal to simplify candidate declaration and notification processes?**

11. This seems like a sensible amendment to a procedure that will preserve SRA resources with no immediate impact on applicants.

#### **Remove the Requirement for firms to carry out reserved legal activities**

**Q5: Do you agree with our proposal to simply authorisation by removing the requirement for firms to carry out reserved legal activities?**

12. Yes; this appears to be a proportionate and practical change. With more dynamic business models in the market place it is entirely possible that some businesses may move in and out of providing legal services over a period of time. In the interim, providing they are meeting the SRA requirements for regulation it seems entirely logical that they could / should remain authorised by the SRA.

#### **ABS Authorisation – operational change and improvements**

**Q6: Do you agree with our proposals to simply the authorisation process for ABSs by:**

- a) Removing the requirement for approval of managers in ABS corporate owners;
- b) Removing the 7 day notification requirement for authorised manager or owner of an Abs?
- c) Revising the rules relating to reserved legal activity?

13. We agree with these proposals. As the ultimate owners of the corporate entities in an ABS, who, in effect, control the managers working within their business, are already assessed under a separate procedure, it seems sensible to remove this duplication of effort. Furthermore, in many cases, the ultimate owners of the corporate entity in an ABS are often the managers as well, so this proposal in our view is likely to remove some duplicate regulatory procedures and checks that add no further assurance or protection to consumers.

**Q7: Do you have any specific concerns regarding the SRA's proposals to simplify the authorisation process for ABSs. If so, please specify what these are.**

14. No. The underlying process, in our experience, is robust. The changes proposed, in our view, appear relatively minor and should simply improve the process.

**Q8: Do you have any specific suggestions for the further simplification or streamlining of ABS authorisation?**

15. There is a great deal of duplication in the information provided as part of an ABS application. We therefore welcome the proposals in this consultation that aim to reduce this duplication.
16. We would argue that there is merit in the SRA adopting a more bespoke approach to managing applications once they are in process. In our experience many applications, for example, seem to progress very slowly due to administrative delays. These include forms bouncing to and fro, the request for additional information and the asking of more and/or different questions. Once an application is submitted we would suggest that a more flexible approach could be taken, such as a conference call to resolve all outstanding issues rather than working through one item at a time by email or hard paper correspondence.

### Changes to insolvency rules

#### **Q9: Do you agree with our proposal to adjust the regulations to cover the event of partnerships entering administration?**

17. Yes. We agree that a rule change should be introduced, to cover a member of a partnership that has entered into administration but where there has not yet been an individual voluntary arrangement (IVA), partnership voluntary arrangement (PVA) or declared bankruptcy.

### Alternatives to client accounts

#### **Q10: Should the SRA approve third party managed accounts?**

18. We are not convinced that the SRA's proposals in relation to the approval of third party managed accounts have been sufficiently well thought through, taking into account not just the relative risks of loss of client funds, as against the increased administrative and regulatory costs passed on to them together with the costs of additional administration and the delays inherent in the involvement of a third party.
19. The following is our analysis of some of the disadvantages that would be incurred / arise if the SRA adopted this approach:
- a) There would most likely be an increased cost to the SRA by operating and regulating two approaches to client funds management. These costs would only increase the regulatory cost for SRA regulated firms and, ultimately, the consumer.
  - b) The use of third party managed accounts will not remove the risk of fraud or misappropriation of client funds. Although any such action would require collusion of both someone within the law firm and the managed account provider, this is still the case where funds are not managed by a third party as many frauds today within law firms are undertaken by a mix of people internal and external to the law firm.
  - c) Based on our discussion with law firms we believe that the uptake of this option would be very low. As a result the SRA may well be unable to offset the additional costs incurred in setting up and administering the scheme.
20. Law firms have explained to us that they would not follow these routes for a number of reasons that include, inter alia:
- a) The models of Barco and the French legal system suggest the use of third party managed accounts is not practical. Barco, for example, works partly due to the fact that many barristers deal with a limited volume of financial transactions, these can be pre-planned and are less time critical. It also works from a practical viewpoint as in many cases such matters are undertaken by a law firm in the background. The French legal system, on the other hand, has a reputation of being slow and cumbersome, in contrast to the UK legal system. Most firms, with whom we have discussed these arrangements, believe there would be considerable delay and increased costs from consumers as a result of operating on such a basis.
  - b) There is no expectation that costs of operating such accounts would ultimately provide any cost saving to firms or consumers.

- c) There is a risk of damage to the UK legal sector's reputation if the use of such arrangements became widespread and resulted in delays within the sector.
- d) Firms we have spoken to did not fundamentally think it would reduce exposure to risk for client funds. For example unless all firms were required to operate under an effective escrow arrangement there would always be an opportunity for firms to operate their own client accounts and undertake a fraud "more easily" if they wished; so unless escrow arrangements were compulsory this risk would remain.
- e) The use of escrow accounts does not entirely rule out the risk of fraud.

**Q11: If so,**

- a) **Should these be assessed and considered by the SRA on a case by case basis; or**
- b) **Should the SRA identify a minimum set of safeguards that should apply to all third party managed accounts?**

- 21. We believe that there should be a set of minimum safeguards in place but providers should also be assessed by the SRA on a case by case basis, with providers approved in advance by the SRA. As a result the SRA would (and should) have some responsibility for ensuring the provider in question remains appropriate.
- 22. We do not think assessment of the strength of the safeguards present in third party providers should be delegated to law firms because we do not believe the majority of them have the required skillsets to form this opinion.
- 23. Despite the costs and resources this consumes at an SRA regulatory level we see this as a key role of the regulator, as the underlying regulation of client money is a key factor that affects the confidence the public has in the legal sector and ultimately their consumer protection.

**Q12: Are there any additional safeguards, not set out in Annex A, that you think we should consider in authorising the use of third party managed accounts?**

- 24. This is a very detailed subject and not one that can, in our view, be easily dealt with, by a short list of required attributes.
- 25. We would expect the regulation around the operation and management of third party providers to be high, given the importance of client funds to the operation of the legal sector. Regulators in the legal sector should not be aiming to reduce its regulatory remit in any way and certainly not by reducing its involvement to the introduction of a few requirements before a third party can take on the effective outsourcing of client transactions.

#### **Guidance on recording of non-material breaches**

**Q13: Does the SRA's additional guidance on recording of non- material breaches provide further clarity on this requirement?**

- 26. The guidance provided is clear in its direction and emphasises the flexibility available to firms in its approach.
- 27. The guidance, however, stresses that firms have an obligation to identify a pattern of breaches. From a practical viewpoint it is difficult to see how a firm could achieve this without some form of breach record being retained internally. In this respect the guidance is arguably contradictory.
- 28. For the guidance to be comprehensive we believe it should be extended to cover the following aspects:
  - a) It should give illustrations of how a firm might be able to identify a pattern of breaches without a formal breach register; and

- b) It should outline some of the potential benefits the firm actually obtains from maintaining a formal breach register (see answer to Q14 below for further discussion of this point).

**Q14: Should the SRA also give consideration to removing the requirement for non-ABS firms to record such breaches? If so, why?**

29. Our view is that this would be detrimental to a firm's risk management and so we think it is important that firms are required to maintain a register of non-material breaches.
30. The process of recording non-material breaches has the following benefits:
- a) It provides an output to evidence actual activity in the firm in terms of compliance systems in operation;
  - b) It allows patterns to be identified over time for the firm to act upon or elevate breaches to material status;
  - c) It will allow external reporting accountants to risk profile firms - this is likely to be an important part of the developing role of reporting accountants. A satisfactory record of breaches may enable them to reduce their work and fees to the firm, ensuring proportionate costs;
  - d) It provides documentary evidence for other (non-compliance) managers in the firm that the necessary compliance systems are in operation thereby enabling them to assess the effectiveness of the compliance officers in their roles. This in turn assists all managers and the compliance officers themselves to discharge their personal obligations under the handbook principles;
  - e) It provides a mechanism for managers to document their conclusion (at the time) as to why a breach is non-material. If this then ultimately proves to be a material issue in the future it at least provides evidence of the information available to them at the time and why they formed their opinion that it was non-material;
  - f) It emphasises the importance of regulatory compliance and to some extent acts as a deterrent / incentive to all individuals in the firm to prevent breaches arising. In the same way that an external accountant's report has a certain deterrent factor, the existence of a breach register can have the same positive effect on fee earner behaviour within a law firm; and
  - g) The development of recurring breaches may not only enable a breach to be elevated to 'material' but may identify improvements that could be made in the client and office control systems.

**Clarification on the outsourcing of legal and operational functions**

**Q15: Does the current rule in relation to outsourcing present unforeseen difficulties to firms wishing to take advantage of cloud computing options?**

31. No comment.

**Q16: Does the addition of a guidance note on Outcome 7.10 provide sufficient clarity or should the SRA make changes to this Outcome to provide further guidance to firms?**

32. No comment.

**Recording and reporting of diversity data**

**Q17: Do you have any comments on the SRA's proposal to clarify the current requirements for the recording and reporting of diversity data?**

33. No.

**Update on Apprenticeship Route to qualification**

**Q18: Do you agree with our proposal to enable qualification as a solicitor through an apprenticeship route?**

34. No comment.

### Fee sharing and referrals

**Q19: Do you consider that Outcome 9.6 should be retained or removed? Please give your reasons why.**

35. This is not an area where we have a great deal of detailed experience. We do however sufficiently understand the proposals put forward. On balance we can see merit in further discussion to amend Outcome 9.6 to allow third party involvement (and referral fees) in this part of the market possibly with some additional safeguards being put in place.
36. We are persuaded by the comments regarding the changes to the legal sector over the last 15 years in the areas of criminal and legal aid supported services. We note, however, that the access to these markets and services is currently being reduced to consumers due to the contraction of providers in the market place. Accordingly we are of the opinion that procedures to link up those in need of advice to providers will be a valuable addition to the market place at this time. Additionally we note that micro law firms do not have the resources to advertise or seek out clients. A referral arrangement could be a cost effective way for these firms to continue in the new legal aid landscape; in turn improving access to justice to the consumer.

### Impact Assessment

**Q20: Annex B sets out the SRA's initial assessment of the impact of the measures set out in the review:**

- Is there any information, data or evidence that you can provide or direct us towards that will assist us in finalising our impact assessment?
  - Do you agree with our assessments of impacts for each proposal?
37. We are not convinced that the assessment of impact in respect of "Alternatives to Client Accounts" adequately reflects the balance of costs and benefits. The total cost of client money fraud or the misuse of client accounts needs to be set against the regulatory and administrative costs and the dangers of adverse delays and inconvenience for consumers. In addition, the introduction of third party providers will only have any meaningful effect if the use of such accounts is compulsory and even then fraud will always remain a possibility where there is collusion.