# SEPARATE BUSINESS RULE

ICAEW welcomes the opportunity to comment on the Consultation paper, *Separate Business Rule,* published by the Solicitors Regulation Authority (SRA) on 20 November 2014, a copy of which is available from this link.

This response of 12 February 2015 has been prepared on behalf of ICAEW by the Business Law Committee which includes representatives from public practice and the business community. The Committee is responsible for ICAEW policy on business law issues and related submissions to legislators, regulators and other external bodies.

This ICAEW response also reflects consultation with the ICAEW Solicitors Group. The Solicitors Group Committee is made up of experts in solicitors' accounts from accountancy and legal practices

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## EXECUTIVE SUMMARY

1. We support the SRA's determination to tackle the abuses identified in the Consultation paper, but we question whether the proposals set out in it are the best way to achieve that outcome. In particular, we question whether the proposals :
   i. adequately address the Legal Services Board's assertion that the Separate Business Rule (SBR) is anti-competitive;
   ii. are appropriately targeted and proportionate; and
   iii. represent the best way to resolve the potential harm to consumers who assume that the association of a person holding themselves out as a non-practising solicitor with their legal service provider will necessarily result in regulatory protection from the SRA.

   We expand on these points below, but in summary we suggest that a better solution would be for the SRA to include within its regulatory reach all legal services which are provided by practicing solicitors or provided under their oversight and then to remove the SBR altogether.

2. The SRA's concerns would be better addressed, and more in keeping with Outcomes Focussed Regulation (OFR), if more emphasis were to be placed on the requirement for non-practising solicitors to act in accordance with the Professional Principles, including the general requirement to act in the interests of clients. SRA regulated firms, individual practising solicitors and businesses with which they or non-practising solicitors are associated, should ensure that clarity is provided to all clients on where their services are provided from, and their rights to regulatory protection. This, together with a ban on non-practising solicitors holding themselves out as providing legal services to the public as **a solicitor** (whether or not non-practising) would provide more than sufficient protection.

3. If this approach was followed the SBR would be rendered redundant and could be deleted from the rulebook. This would be our preferred option.

4. The SRA already has, and should continue to ensure that it has, a general ability to discipline any solicitor (practising or not) who acts in any way which is so egregious that it would be likely to bring disrepute to their profession. We suggest that this power should be applied more proactively against any solicitor failing to comply with the Professional Principles.

5. Some of our comments do not fall easily under the questions posed in the on-line response form. We address these under 'Major Points not covered in Specific Questions' below and then answer the specific questions asked in the Consultation paper. We would point out that these specific questions posed by the SRA do assume that the retention of the SBR, albeit with some changes, has already been decided; as we state above we do not agree that this would be the most appropriate outcome but we have nevertheless answered the specific questions in accordance with the SRA's request in the consultation document.

## MAJOR POINTS NOT COVERED IN SPECIFIC QUESTIONS

### Basis of SRA Proposals

6. We welcome the SRA's acknowledgement that any rule change must primarily focus on increasing client /consumer protection. However, this should not be allowed to undermine the importance of the other regulatory objectives as set out in Part 1of the Legal Services Act 2007 (LSA), such as promoting competition. With regard to this we do not believe that the Consultation paper goes far enough in answering the Legal Services Board's assertion that the SBR is anti-competitive and should be removed. Nor do the SRA's proposed reforms go far enough to ensure that regulatory action is targeted to cases where action is needed. We would suggest that that the SRA should be more proactive in its application of a 'principles' and 'outcomes' based approach as this will allow flexibility and still address the concerns for which the SBR was originally intended.

7. We consider that the best way to achieve client protection (without disproportionate regulation) is for the SRA to oversee the regulation of all services provided by practising solicitors. A more proportionate response to the problems of confusion caused to clients by their perception that legal services associated with non-practising solicitors will attract regulatory protection from the SRA would be to ban them from holding themselves out as solicitors or providing legal services to the public in the capacity of a solicitor.

8. As the Consultation paper notes most of the other approved regulators under the LSA do not impose a SBR and do not find consumer protection or access to justice compromised by the lack of one. In particular we note that the Law Society of Scotland does not impose such a rule. Before finally concluding that it is necessary to retain the SBR the SRA should carry out some research into whether a similar measure is considered necessary in other Common Law jurisdictions such as New Zealand and Canada. In this regard we would note the ICAEW's model of supervision as one example of an alternative to the SBR. In a similar approach to that of the SRA, ICAEW protects the client/consumer and regulates the activities of both individual chartered accountants and member firms by a system of practising certificates, practice assurance and compulsory professional indemnity insurance, but without imposing a SBR.

9. As noted in paragraphs 70 to 73 inclusive of the Consultation paper, possibly the greatest risk to clients occurs when they perceive a firm to be regulated by the SRA, when in fact the majority of the services it offers are not. We note that the SRA is concerned that the SBR can in some instances be used to facilitate this deception (as noted in paragraph 72). The issue is therefore one of clarity on the part of the legal services provider and understanding on the part of the client as to the regulatory protections that they are entitled to, in relation to each part of their service provision, and the body which supplies that protection. The primary purpose of any amendment to the SBR should seek to address this.

10. Although the aim of the LSA is to increase access to justice by liberalising the market and increasing competition, the SRA should still act on the basis that its primary concern should be focussed on the protection of the clients of its regulated population. By altering the SBR, the SRA should take care that the desire for solicitors to increase their service offerings does not override other considerations. We note that this could be drawn as an implication of the wording of paragraphs 5 to 7 of the draft Impact Statement. We would reiterate, however, that we believe that the solution is not to amend the SBR but to replace it with more principles based regulation, extending to all services provided by practising solicitors (either directly or under their supervision) to the public, to the extent necessary on a risk related basis.

## The Definition of "Legal Services" and their Regulation

11. The definition of legal services in the LSA is very broad and as noted in the Consultation paper unlikely to be redrawn in the near future. In our view the consultation does not give sufficient consideration to the following:
    - Which services, provided by practicing solicitors or supervised by them, should be within the regulatory reach of the SRA, in order to provide appropriate protection from the activities the SRA are concerned about: questionable or unconscionable conduct by solicitors or their associates.
    - Which services may be within a wider interpretation of the LSA's definition of legal activity, but are subject to adequate and appropriate non-legal services regulation.

12. The distinction between those unreserved legal services which should be regulated by the SRA, and those which are appropriately regulated by other bodies would be rendered unnecessary, however, if the SRA were to:
    - regulate all legal services provided by practising solicitors or under their supervision;

- adopt a general rule that non-practising solicitors should not hold themselves out as solicitors or provide (in the capacity of a solicitor)) legal services to the public; and
- take a proactive approach to the enforcement of the general objectives of SRA regulation (through OFR) which apply to all solicitors, whether practising or non-practising.

### Consultation Process

13. The Consultation paper appears to have been drafted on the assumption that the starting point for a change is a remodel of the status quo (see for example, paragraph 1 and paragraphs 21-22), rather than an analysis of any alternative and possibly better models of regulation. For example paragraph 4 states simply that 'a separate business rule is necessary' and paragraph 28, whilst acknowledging that there is no statutory requirement for the SBR, concludes that the 'the SBR is maintained as a matter of policy'.

14. Furthermore the Consultation paper appears to be principally addressed to members of the existing regulated population (primarily solicitors) rather than consumers. We trust that representatives of the users of legal services (such as, for example, the Federation of Small Businesses, the Consumers Association, and the British Chambers of Commerce) and other regulators (statutory and non-statutory) whose work may overlap with that of the SRA (such as the FCA, STEP and Trading Standards Departments) will be consulted.

## RESPONSES TO SPECIFIC QUESTIONS

### Q1: Do you have any comments on our conclusions from the market analysis, and any additional information or data to supply to assist that analysis?

15. We agree with your assessment that the market for legal services is continually evolving and that the current system of regulation overlooks some, but equally over regulates other providers of mainstream legal services. We also agree that the needs of consumers are not necessarily or fully met by the 'traditional' solicitor and this renders it necessary to ensure that there is a choice of providers without compromising consumer protection. Finally we also agree that the market in legal services provided by commercial organisations not regulated under the LSA has expanded far beyond the Government's expectations as encompassed within the design of the LSA and needs to be monitored carefully.

16. In other respects, however, we would suggest that the market analysis as presented would be considerably improved by consideration of the following:
    - services which may fall within a wider reading of the definition of "legal activities", but would not normally be regulated by the SRA, nor would it be within the expectations of consumers that they should be; and
    - regulation other than by LSA statutory regulation, and the circumstances under which this would be appropriate and sufficient for the protection of consumers.

### Q2: 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?

17. We agree that the ban on links with separate businesses should be removed, but suggest that replacing it with a different but equally inflexible and unhelpful rule is unlikely to be in the interests of clients/ consumers. Rather, it should be replaced with more emphasis on the spirit and practice of OFR. We do not believe that the specific rules proposed are effective in providing the necessary protections, without damaging the cost effectiveness of a well-managed group of service providers, and thus damaging competitiveness and the interests of clients/consumers.

18. In particular, the requirement for " informed consent" for referrals will unnecessarily damage efficiencies of service within a group of service providers without providing the additional necessary protections. It is notoriously difficult to ensure, particularly for vulnerable clients, that "informed consent", has been properly obtained and to demonstrate that it has. This means that well managed firms will be likely to incur disproportionate costs in ensuring that the client has really understood what they are consenting to, and providing adequate records of that fact. In contrast, it will be almost equally onerous for the SRA to demonstrate that a less well-intentioned firm has neglected to ensure that the consent they have recorded actually is properly informed. This does not provide cost effective regulation.

19. Furthermore the recommendation in paragraph 7(c) that a client should only be referred to a separate business 'when it is in the client's best interests' is imprecise and subjective. It should be (and we understood is) a fundamental ethical requirement on all solicitors that they should always act in the best interests of their clients.

**Q3: Do you agree that solicitors should not be allowed to describe themselves as non-practising solicitors when providing servces to clients or potential clients in a separate business?**

20. We believe that non-practising solicitors should not be permitted to hold themselves out as providing legal services to the general public **as solicitors** (whether or not describing themselves as non-practising solicitors) from a business not regulated by the SRA.

**Q4: Do you agree with our proposal to prohibit specific referrals that split matters involving or related to reserved activity?**

21. No. The referral of matters within a uniformly well -regulated and well-controlled group of firms is both cost effective and in very many cases in the interests of clients in other ways as well. For example clients will be dealing with a familiar overall entity and communication is simplified by the easy exchange of information (with client consent) within the group. It is anti-competitive and unnecessary to prohibit any category of referral which has the potential to be in the interests of clients/ consumers.

**Q5: Should further specific bans on referrals be included or would a general outcome such as that described in paragraph 113 be more apprpriate?**

22. We agree that there should be no further specific ban on referrals. Further, we consider that a principles based approach is preferable, where this is adequate for the protection of clients, and that this could appropriately applied by the addition of a mandatory outcome, preserving the interests of clients.

23. However, we suggest that it is not appropriate to use wording for any outcome that "forbids" something that may in some circumstances be in the interests of clients – which may be the case, for example, in relation to referrals to firms of Chartered Accountants, regulated as such by their professional body, including in relation to many aspects of estate administration. OFR should rather be applied with sufficient flexibility to enable the best outcome for clients to be provided.

**Q6: Do you have any other comments on draft Chapter 12 of the SRA Code of Conduct?**

24. As noted above, our preference would be for the complete removal of the SBR and its replacement with other content in the Code, relating to the conduct of solicitors when providing, or supervising, the provision of any legal service to the general public in their capacity as a solicitor (including on a pro bono basis).

25. If this is not practical, in the short term or at all, we think that it is essential that the Proposed Rules should be changed as set out below (paragraphs 27-30 inclusive), to avoid unnecessary detriment to the interests of some clients, and to the competitiveness of the provision of legal and other services.

26. We note that the revised definition of "separate business" in Annex 2 is very wide, and in particular does not exclude businesses that provide goods or services wholly unrelated to legal activities. If the proposed changes we suggest below (paragraphs 27 to 30 inclusive) are implemented, then this is quite appropriate. Solicitors should not be associated with any business which treats its clients or customers unfairly. However, if the restrictions on referrals are retained, then it is wholly inappropriate for this to apply to a separate business unrelated to the provision of any legal activity.

27. In Draft Rule O(12.1) we consider that:
– paragraph (a) should have the words "and by which body/ies" added at the end. Legal services regulation is not the only regulation that provides appropriate protection to clients, and they should be fully informed of the other regulatory protections to which they might be entitled.
– we suggest that an additional paragraph should be added to this Rule, requiring clients to also be informed as to their entitlement to redress. Redress (such as that supplied by LeO, for example) is a separate issue to regulation, and should be treated as such.

28. Draft Rules O(12.2), (12.4) and (12.5) should be removed in their entirety. In some circumstances such referrals will be in the interests of clients, as well as promoting competition. Provided appropriate controls are in place, such referrals should not be restricted.

29. We note that 'informed consent' is not italicised in O(12.3). This means the term is not defined in the SRA Glossary 2012. We comment above (in paragraph 18) on the difficulty of applying this criterion to the acceptability of referrals, and consider that this element of the Draft Rules (from "and when the client" to the end) should be removed from this Rule. If it is retained, clear guidance on the definition, and the evidence which will be needed to be able to demonstrate that it has been obtained might assist but would not remove the core difficulty. It is sufficient, and less open to manipulation, if more emphasis placed on the requirement for all solicitors to comply with the Professional Principle of acting in the best interest of clients. That requirement does not require either this outcome, nor a SBR, since it is already an overall requirement on all solicitors.

30. Our strong preference would be for Draft Rule O(12.6) to be removed and replaced with a general Rule to the effect that practising solicitors should not provide any legal services (reserved or non-reserved) unless these are provided under the regulatory remit of the SRA or any other approved legal services provider.

31. Paragraph 116 of the Consultation paper notes that authorised persons will be required to notify the SRA of their connections to separate businesses. We consider that this would be an appropriate control, allowing the SRA to better assess regulatory risk. However, we cannot see a draft Rule introducing this requirement.

**Q7: Do you have any comments on the case studies or any suggestions for further examples for inclusion?**

32. Our main concern is that there are no case studies addressing circumstances where (due to the very wide definition of "legal activities" in the LSA) a separate business may be providing services under better targeted and adequate regulation than legal services regulation. Under such circumstances it may not be normal for clients to have a reasonable expectation of SRA regulatory provision, and nor should it be imposed.

33. The Key given at the beginning of Annex 3 includes examples of cases where the SRA authorised firm is "connected with" or "participates in" the separate business, but all the case

studies presented relate to direct ownership interests. It would be helpful if case studies could also cover other possible connections such as common ownership of an SRA regulated firm and a separate firm also providing services within the LSA definition of legal activities.

34. It would also be helpful to address in a case study, situations where the separate business is acting in areas where alternative regulatory provisions are known to have areas of inadequacy, such as acting as a bailiff where the Government is currently reviewing regulatory needs.

35. In Appendix 1 we have suggested a number of case studies, which help to illustrate some of the problems inherent in the current proposals. Of course, if these problems are removed, then no advice will be necessary from the SRA on how their regulated population should address them in a proportionate way.

**Q8: Do you have any comments on our draft Impact Statement or any data or information to add?**

36. We would suggest that an analysis of the impact of the proposed reforms would be more helpful than a statement and that it should include an analysis of other available alternatives.

37. As paragraph 3 of the draft Impact Statement notes public interest is compromised when the regulatory framework causes confusion to clients. By acknowledging that a change to the SBR is required, the SRA is implicitly acknowledging that the current SBR is one cause of such confusion. The proposed change does not alleviate this problem. We would suggest that the only way to avoid such confusion (and the consequent risk of detriment to the client) is for all practising solicitors to be regulated as such and for non-practising solicitors to be forbidden from holding themselves out as providing legal services, of any kind, to the general public **as solicitors**.

38. Paragrah 31 of the draft Impact Assessment states that replacing the need for waivers with a rule with clear principles will improve accountability. We do not think that clarity has yet been achieved. Nor do we consider that the need for waivers will have been replaced – see for example Case Study C in Appendix 1 below.

**Q9: Do you agree that recognised bodies and Recognised Sole Practitioners (RSPs) should be allowed to provide the additional services proposed?**

39. We would agree that the services provided by recognised bodies and RSPs should be reviewed to reflect changes in the market, and be extended to the extent possible within their own competence and that of the SRA to regulate them. We would note, however, that we have much anecdotal evidence of the poor understanding of many solicitors of the detailed requirements of tax and accounting law, and in particular their ability to prepare financial statements in accordance with all applicable accounting standards or tax returns which take account of all the circumstances of the client. If these services are to be provided to clients other than by properly qualified and regulated accountants, then it will be essential for the SRA to ensure that the solicitors supervising these services have the appropriate understanding, and that the SRA has the skillset necessary to regulate such accountancy services.

**Q10: Are there any other services that should be allowed, bearing in mind the restrictions in s9(1A) of the Administration of Justice Act 1985 and the regulatory objectives?**

40. Yes. We would suggest that any professional services should be permitted by the SRA, where these are permitted under the terms of any relevant legislative provisions, and provided that they are subject to appropriate regulatory provisions of the LSA or non-LSA regulation.

**Q 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.**

41. We suggest that the SRA should be moving away from blanket and onerous regulation to a more flexible OFR approach. If solicitors are not providing anything associated with legal services, or are working in situations where clients could not reasonably expect to be covered by SRA regulation, then such regulation in unnecessary; further, it is unlikely to be in the spirit of reducing cost and bureaucracy, or of increasing competition and liberalising the markets.

Appendix 1 Case Studies

**Case Study A**
**Mr X is a sole practitioner solicitor, operating to a good standard and with no regulatory concerns on the part of the SRA. He is also a part owner of a flower shop run by his wife, Mrs X. No customers of the flower shop have raised any concerns or made complaints to the local authority's Trading Standards Department.**
Because the SRA's definition of a 'separate business' is not limited to businesses providing legal activities, or where consumers could reasonably expect any level of legal services regulation, Mr X concludes that he needs the informed consent of his clients before he can suggest that they buy flowers from his wife.

**Case Study B**
**Logistics Giant is a very large diversified firm, operating in many areas related to the transport of goods. They have always employed a number of solicitors in their In-House legal team, where a proportion of their work is concerned with legal issues arising from road traffic accidents. These sometimes lead to subsequent litigation, also dealt with by the In-House team, to the maximum extent possible. Logistics Giant recently recognised the business opportunity represented by this team also providing these services to small transport providers, and set up LG Legal, a firm regulated by the SRA, to provide legal services to third parties, both reserved and non-reserved.**
**Logistics Giant also has a similarly highly skilled internal department which deals with problem issues concerned with the mechanical safety of transport vehicles, which they are similarly setting up as a separate subsidiary, LG Mechanical, with a view to providing services to the public and in particular small transport providers. Central to such services is advice on whether particular service standards comply with road safety legal requirements.**
LG Mechanical provides services which are within the LSA definition of legal activities, as advice on compliance with legal obligations, but which nevertheless are outside clients' reasonable expectation of what should be under the regulatory remit of the SRA. Nevertheless, informed consent would be required for a referral.

**Case Study C**
**Y Chartered Accountants is a member firm of the ICAEW, and works under its practice assurance requirements. It sets up a subsidiary Y Legal, authorised by the SRA, to provide reserved and unreserved legal services, primarily to their own clients but also to the general public, where these are related to services provided by Y Chartered Accountants, but which are not within the usual competence of their partners and employees. Y Chartered Accountants is not authorised under the LSA.**
Y Chartered Accountants & Co provides general legal advice on tax law and the requirements of the Companies Act. This advice is frequently central to, rather than a necessary part of, particular client engagements. It is very clear to clients, from their engagements letters, from the respective notepapers of the two firms, and so on, when they are receiving services from a firm of Chartered Accountants, as an accountancy service, and when from the legal firm, and the regulatory protections to which they are entitled in each case. Accountancy services are outside a client's reasonable expectation of what should be under the regulatory remit of the SRA. Nevertheless, informed consent would be required for a referral.

Under the current SBR, Y Chartered Accountants could reasonably expect to be granted a waiver, since clients could expect an equivalent level of regulatory protection under the requirements of ICAEW. If this is not granted under the revised Rule, the clients of the Y Group will be unnecessarily disadvantaged, due to the inconvenience of having to restate have their informed consent in relation to every transfer of business between the two arms of the business, and having ultimately to bear the costs and delays inherent in this increased administrative burden. If waivers are granted under the revised Rule, this completely undermines the thinking behind the current proposed changes.