



The Law Society

The Law Society's briefing on the SRA's Looking to the Future consultation

Briefing for local law societies

July 2016



SRA Handbook consultation

THE LAW SOCIETY – MEMBER BRIEFING

Foreword

The SRA published its consultation Looking to the Future on 1 June. The deadline for response is 21 September 2016.

This briefing is designed to help our members consider the implications of the proposed changes.

Over the summer, the Law Society will be conducting a wide-ranging dialogue with our members through events, briefings and discussions with local law societies, as we seek to gather opinions and evidence about the possible impact of these proposals.

We want to hear from as many people as possible - face-to-face, by email and in response to surveys and other activities we are planning. We will be submitting a full and evidence-based response to the consultation and urge the profession to consider the implications of the proposed changes and get in touch.

Solicitors wanting to give feedback can email us on regulation@lawsociety.org.uk

Catherine Dixon

Chief executive

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Executive summary

The Solicitors Regulation Authority's (SRA) proposals for changes to their Handbook for solicitor and firm regulation, if accepted, will leave clients and consumers with less protection and could result in a 'two-tier' solicitor profession.

The SRA proposals will enable solicitors to work for unregulated entities providing unreserved legal activities to the public. Such solicitors will be subject to a new Code of Conduct for Solicitors but the organisations they work for will not be subject to the SRA's proposed new Code of Conduct for Firms, which will continue to uphold a range of current protections for clients and consumers.

This has potentially serious implications in a number of areas including: client protection, legal professional privilege, professional supervision, competition and the standing of the solicitor profession. There are also a number of areas of ambiguity in the proposals which will require further clarification from the SRA such as the precise application of the new rules to sole practitioners. The main areas of concern are:

The creation of a 'two tier' market

The proposals could result in two tiers of solicitors - those working in a regulated entity and those who are not - with different rules and protections applying to clients, depending on where the solicitor is working.

Legal Professional Privilege

Advice from solicitors in unregulated entities may not be legally privileged. If part of the solicitor profession is unable to give legally privileged advice, this is a slippery slope which could erode the concept of LPP, a cornerstone of the justice system and a key right of clients. This could also undermine the standing of the solicitor profession both at home and abroad.

Professional Indemnity Insurance / Compensation Fund

Solicitors working in unregulated entities may not be required to have professional indemnity insurance. Their clients may also not have access to the compensation fund or access to the Legal Ombudsman if things go wrong. This risks eroding a key element of current client protection.

Supervision

Changes to supervision requirements would mean that newly qualified solicitors with no experience would be able to set up their own unregulated firms. Newly qualified solicitors generally welcome the support and guidance from more experienced solicitors and this is also a key driver of quality of service. If that's not available it could place clients as well as newly qualified solicitors at risk, and negatively impact on the standing of the solicitor profession.

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Conflicts / Confidentiality

Unregulated organisations will not be subject to the SRA rules of conflict and confidentiality although individual solicitors in those organisations will. This means that unregulated entities will be able to act in situations where regulated entities would not. It also creates complexity for individual solicitors in unregulated entities who will have to comply with the SRA rules on conflicts and confidentiality, and leaves regulated firms at a disadvantage. Significantly, it also removes protections for clients in unregulated entities which are deemed important for regulated firms to comply with.

Accounts rules

The SRA proposes to change the definition of client money to allow money paid for all fees and disbursements for which the solicitor is liable to be treated as the firm's money. In parallel, the SRA proposes to simplify the accounts rules which might create uncertainty as to whether a firm is compliant. Finally, the SRA is proposing to allow solicitors to use third party managed accounts.

Enforcement

If the proposals are accepted, the SRA handbook will be shorter. Although this could be superficially attractive, many solicitors prefer a clear set of "dos" and "don'ts", as compliance with such is arguably clearer. It is not clear from the consultation how the system of enforcement will work under the new codes - we are concerned that this lack of clarity creates ambiguity.

Summary: Loss of client protection and lack of clarity.

Although the proposed changes seek to simplify the SRA Handbook, there are a significant number of ambiguities. It is also clear that client protection will be eroded, especially when clients instruct solicitors in unregulated entities. Clients will have different protections depending on where the solicitor works. We are concerned that this is not in the interests of the profession, its clients or the public which relies on a strong and vibrant legal profession to uphold the rule of law.

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In more detail

Briefing on SRA consultation: 'Looking to the Future'

The SRA's [Looking to the future: flexibility and public protection](#) consultation represents the initial phase of a planned programme of reform of the SRA Handbook¹. This initial phase sets out the detailed changes to the Code and is seen by the SRA as laying the foundations for simplifying the rest of the handbook. Responses are invited via an [online consultation questionnaire](#) (which sets out 33 questions) by **21 September 2016**.

Views are sought on:

- a new set of SRA Principles
- a new shorter Code of Conduct for Solicitors
- a new shorter Code of Conduct for Firms
- the proposal that solicitors should be able to deliver non reserved legal services to the public from providers that are not regulated by the SRA or another legal services regulator
- new Accounts Rules.

Underlying approach

The SRA argues that the change is needed because of the rapidly diversifying legal market, which makes the existing 2011 Handbook² obsolete. The intention behind the changes to both the Code of Conduct and the Accounts Rules, is that the SRA will take a less prescriptive approach to regulation, allowing solicitors more freedom in the way they chose to practice. It is considered that this will promote innovation, which will reduce costs for consumers and allow unmet legal need to be met. In so doing, the consultation could be argued to herald the end of the pre-eminence of traditional legal practice, particularly via redefining the regulatory vehicle through which a solicitor may practise. As well as promoting a less prescriptive approach, the SRA intends creating a shorter and simplified Handbook. However, we are concerned that the proposals will result in reduced client protection depending on where the solicitor is working, which is likely to be confusing and not in clients' best interests.

The (overarching) SRA Principles

The intention is that the ten mandatory principles (2011 Code) are reduced to six. Most significantly, the 'lost' principles include *'provide a proper standard of service to your clients'* and *'protect client money and assets'*, which may cause some concern from both a standards and protection perspective.

The Outcomes and Indicative Behaviours have been removed from the Handbook. Indicative Behaviours were intended to be indicators and it is worth noting, in this context, that the SRA intends supplementing the Handbook with guidance and case studies.

¹ Later in 2016, the SRA will consult on amending the practice framework and authorisation rules.

² The existing Handbook has been described by the SRA as being built on the (outdated) assumption that nearly all solicitors are practising in private practice.

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Relevant SRA Consultation Questions

- Do you agree with our proposed model for a revised set of Principles? (Q.2)
- Do you consider that the new Principle 2³ sets the right expectations around maintaining public trust and confidence? (Q.3)
- Are there any other Principles that you think we should include, either from the current Principles or which arise from the newly revised ones? (Q.4)

Two Codes of Conduct

The consultation proposes the creation of separate codes of conduct: A Code of Conduct for Solicitors, which focuses on professional standards and the behaviour expected of solicitors; and a Code of Conduct for Firms, which concentrates on the business systems and controls that firms need to put in place. It could be argued that this approach provides clarity and recognises the necessary distinction between the two. However, on the other hand it is arguable that this approach potentially adds complexity, creates duplication and is unnecessary.

We believe that in the event of such a split between entity and market regulation (the Code of Conduct for Firms) and professional standards (the Code of Conduct for Solicitors), professional standards would be best owned and driven by the solicitor profession as envisaged by Clementi. It is the profession which knows what good looks like and it is important that the market is regulated consistently in line with a risk based approach.

The SRA's proposals will result in two tiers of solicitors with those working in regulated entities having to comply with a greater regulatory burden than those in unregulated entities - irrespective of the risk to the client.

The SRA's proposed approach benefits it by allowing the clear articulation of individual responsibilities so that it can continue to regulate those solicitors who operate through an unregulated entity (albeit that the entity itself will not be regulated).

The overall emphasis with both Codes is on brevity and simplicity. While this will make the Codes easier to read and digest, we know that our members particularly those from smaller firms like certainty and that many would rather have a definitive 'do this' or 'don't do that' approach, where compliance is arguably clearer. There is likely to be real concern that a high-level Code may mean that there is no clear path through the 'grey' areas holding the potential for more disputes with the SRA, with the most serious, no doubt, triggering enforcement action. A further related concern is likely to be that the language is so vague and loose that in many cases it could mean that members carrying on practice in a fully compliant way now, would potentially be in breach after the code comes into force, i.e. it gives the regulator too much unpredictable power to determine whether something is a breach.

³ *'ensure that your conduct upholds public confidence in the profession and those delivering legal services'*

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There is some overlap between the two Codes, most noticeably in areas such conflict, complaints and client information/identification. It is not clear which would take precedence in the event of there being a conflict between the two Codes.

Relevant SRA Consultation Questions

- Have we achieved our aim of developing a short, focused Code for all solicitors, wherever they work which is clear and easy to understand? (Q. 6)
- In your view is there anything specific in the Code that does not need to be there? (Q.7)
- Do you think that there anything specific missing from the Code that we should consider adding? (Q.8)
- Have we achieved our aim of developing a short focused Code for SRA regulated firms which is clear and easy to understand? (Q.10)
- In your view is there anything specific in the Code that does not need to be there? (Q.11)
- Do you think that there anything specific missing from the Code that we should consider adding? (Q.12)
- Do you have any specific issues on the drafting of the Code for Solicitors or Code for Firms or any particular clauses within them? (Q.13)

Conflicts of Interest

The consultation raises the possibility of a new approach to conflicts of interest between clients (see alternative drafts for new rule 6 of the SRA code of conduct at pages 17/18 of the [consultation paper](#)):

- Option 1 largely replicates the 2011 Code, in prohibiting a solicitor from acting where there is a conflict or significant risk of conflict unless specified circumstances are met and protections provided;
- Option 2 would narrow the ability to act given that it provides for a complete bar on acting where there is an actual conflict, and protections where there is a significant risk of a conflict.

Relevant SRA Consultation Question

- What are your views on the two options set out for handling actual conflict or significant risk of conflict between two or more clients and how do you think they will work in practice? (Q.9)

COLPs and COFAs⁴

The roles of COLP and COFA will be retained under the new rules although there may be some (as yet unspecified) changes in the way in which they operate in the interests of reduced bureaucracy.

Relevant SRA Consultation Questions

⁴ In light of the statutory requirement for a head of legal practice (HOLP) and head of finance and administration (HOFA), as set out in sections 91 and 92 of the Legal Services Act 2007, the existing role of compliance officers cannot be abolished.

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- Do you agree with our intention to retain the COLP and COFA roles for recognised bodies and recognised sole practices?
In responding to this question, please set out the ways in which the roles either assist or do not assist with compliance. (Q.14)
- How could we improve the way in which the COLP/COFA roles work or to provide further support to compliance officers, in practice? (Q,15)

Provision of unreserved legal services through unregulated providers

The SRA proposes that solicitors should be permitted to deliver non-reserved legal services to the public through an unregulated alternative legal service provider (ALSP). Enabling solicitors to do so requires careful consideration. As well as allowing unregulated providers to employ solicitors to provide services to the public, it would allow solicitors' firms to hive off their unreserved work to unregulated entities. We believe the proposal is unlikely to provide the benefits identified by the SRA [enhanced standards; increased employment opportunities; strengthened brand; and more competitive and greater access for consumers] - in fact the reverse is more likely, and could have undesirable and/or unintended consequences, for example:

LPP: The consultation leaves it unclear as to whether LPP would apply to a client who is advised by a solicitor working for an ALSP. The Society believes that LPP should attach to clients seeking advice from a solicitor holding a current practising certificate wherever he or she practises and would be extremely concerned by any attempts to dilute or make LPP more difficult to obtain or enforce. A situation where clients are unclear or misinformed about their entitlement to a right to LPP is also clearly undesirable. Finally, we do not believe that it is right in principle for LPP to be a distinguishing factor between regulated and unregulated service providers.

Conflicts and confidentiality: The Society is likely to wish to express its concern about the implications of a situation where the Code requirements around conflict and confidentiality will only apply to individual solicitors working in an ALSP but not to the ALSP as an entity or to other employees. This presents an inherent risk that a solicitor may unwittingly act in a conflict situation and that clients may not be aware of a potential or real conflict of interest or of the fact that the ALSP is not subject to the rules on conflict. It may also encourage firms to become unregulated for fear of losing clients to unregulated competitors. This has already been identified as an issue for City firms. If a US style system for conflicts were to be adopted generally, this may alleviate the position but it may still remain problematic because it creates an uneven playing field between regulated and unregulated firms.

Consumer protections (PII and Compensation Fund): Solicitors working in ALSPs would not be required to hold PII under minimum terms and conditions or contribute to the Compensation Fund, and their clients would not be able to access the Solicitors Compensation Fund. The SRA proposes that solicitors in these circumstances would be required to make sure that their clients understood whether and how the services they provide are regulated and the protections available to them. The proposals significantly reduce the protections available to solicitors' clients and while we support the requirements around provision of information, there is evidence that for, at least, a significant minority of

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consumers an assessment of regulatory status (and the protections therefore available) does not play a major part in the choice of provider.

In relation to the Compensation Fund, it is worth noting that not all claims paid by the Fund relate to reserved work. The wider, practical implications of removing access to the Compensation Fund for solicitors working in ALSPs, which include Fund viability, need to be addressed by the SRA (for example, the potential for increased contributions to the Fund by those in firms authorised by the SRA and handling of contributions when a solicitor moves between regulated and unregulated entities). Moreover, the fund belongs to members so it is questionable whether it is appropriate for the SRA to make any changes which could have an impact on fund viability without balloting members. Finally, this fund is for clients who suffer fraud at the hands of their solicitor and it will be a significant detriment for clients of firms that do not have the protection of regulation to be excluded from the protections offered.

Consumer confusion about status: Solicitors will be able to use their title whether they are providing legal services to the public through a regulated or unregulated entity as long as they hold a practising certificate. However, a provider will not be able to use the term 'solicitors firm' or 'solicitors' unless the firm is regulated by the SRA. The Society does not agree with the SRA that requiring the latter distinction will mitigate consumer confusion and is concerned that it could have the opposite effect. Few, if any consumers, are likely to distinguish between a regulated 'solicitors firm' and an unregulated 'law firm' or 'legal services firm' and the protections they provide. Internationally, this could cause reputational damage, as those outside the jurisdiction struggle to identify regulated law firms. There is no prohibition against unregulated entities advertising that they employ solicitors, which will be even more confusing.

Annual firm practising certificate (PC) fee: It may be necessary to ask the SRA to undertake and publish an analysis of the projected impact on the PC fee, and in particular the turnover based firm fee, of allowing solicitors to hive off unreserved work to an unregulated firm. The SRA should not close this consultation until this information is available.

Reputation and standing of solicitors

There are concerns around the ALSP proposal and its impact on client protection and the reputation and standing of solicitors, because:

- it may result in two tiers of solicitors;
- those working in unregulated businesses are unlikely to be able to give advice which is legally privileged, will not be subject to conflicts rules, will not be required to have PII and will not be subject to the same confidentiality and information security rules as those working in regulated entities; and
- the public will not make a distinction between solicitors working in a regulated business and those working in an unregulated business. They are more likely to think (wrongly) that when they are dealing with a solicitor they have consistent levels of protection..

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Relevant SRA Consultation Questions

- What is your view of the opportunities and threats presented by the proposal to allow solicitors to deliver non-reserved legal services to the public through alternative legal services providers? (Q.16)
- How likely are you to take advantage in the greater flexibility about where solicitors can practice as an individual or as a business? (Q.17)
- Do you agree with our approach that solicitors working in an alternative legal services provider should not be allowed to hold client money in their own name? (Q.23)
- What are your views on whether and when in house solicitors or those working in Special Bodies should be permitted to hold client money personally? (Q.24)
- Do you agree with our proposal that the SRA Compensation Fund should not be available to clients of solicitors working in alternative legal services providers? If not, what are your reasons? (Q.25)
- Do you agree with our view that it is not desirable to impose thresholds on non-SRA regulated firms, which are mainly or wholly owned by SRA authorised solicitors? (Q.30)
- Do you have any alternative proposals to regulating entities of this type? (Q.31)
- Do you have any views on our proposed position for intervention in relation to alternative legal services providers, and the individual solicitors working within them? (Q.32)

In-house: By ceasing to separate out core regulatory provisions for in-house solicitors, the SRA will put in-house solicitors on an equal footing with other solicitors. The Society welcomes this acknowledgment that in-house solicitors are (as they always have in fact been) an equal part of the profession.

It is proposed that in-house solicitors should no longer be prevented from only acting for their employer. This is intended to enhance access to justice for consumers in order to allow primarily local authority legal departments to provide advice to the public, and to others that currently they need SRA waivers to provide advice to e.g. public bodies outside their local areas. In practice, this change will mean any in-house solicitor can provide advice and assistance to the public, provided they are not carrying out one of the reserved legal activities. However, when solicitors working in an unregulated entity provide advice to individuals or organisations other than their employing organisation, it is likely to be the case that their advice will not have the protection of legal professional privilege which will be a significant concern for local authorities, and indeed other in-house teams. Also many of the issues applicable to solicitors working in unregulated entities as set out in this paper, will apply – including concerns in relation to conflicts and PII.

Finally, and critically the section of the draft code dealing with LPP is silent on its application to in-house solicitors, irrespective of whether they are providing advice solely to their employing organisation. This requires consideration and clarification.

Relevant SRA Consultation Questions

- What are your views on whether and when in house solicitors or those working in Special Bodies should be permitted to hold client money personally? (Q.24)

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Special Bodies

The SRA is using the consultation as an opportunity to address the anomaly of 'special bodies' - not for profit organisations such as trade unions, law centres and Citizen's Advice Bureaux. These bodies have been subject to transitional arrangement provisions in the Legal Services Act 2007, meaning that while the solicitors they employ are regulated by the SRA, the body remains unregulated. The SRA's suggested new approach is to treat special bodies in the same way that it currently treats multi-disciplinary practices⁵. These bodies play an important role in providing access to justice for vulnerable people who may not be able to afford access to legal services. We believe that, as well as considering the impact of the proposals on bodies such as Law Centres, there needs to be a detailed analysis of the impact on the market, and other providers in the market, of bringing these providers into the regulated sphere.

Relevant SRA Consultation Questions

- What are your views on whether and when in house solicitors or those working in Special Bodies should be permitted to hold client money personally? (Q.24)
- Do you think that we should retain a requirement for Special Bodies to have PII when providing reserved legal activities to the public or a section of the public? (Q.28)
- Do you have any views on what PII requirements should apply to Special Bodies? (Q.29)

Accounts Rules

The SRA launched 'Looking to the Future: Accounts Rules review' alongside 'Looking to the future: flexibility and public protection' in June 2016.

The SRA's Accounts Rules (SARs) consultation is the final phase of the SRA's three phase review of the SARs⁶ and makes proposals for broader change. The SARs have not changed significantly for many years and in the SRA's opinion, they do not comply with the Government's Better Regulation principles. The SRA argues that the length and complexity of the SARs makes it difficult for new entrants to the market to understand what is required of them as well as consumers to understand what to expect when a firm handles their money. Further, many firms find themselves in technical breach of the Accounts Rules in circumstances where there are no real risks to client money. These rules will of course only impact SRA regulated firms.

⁵ MDPs - alternative business structures providing a mixture of legal and non-legal services - where reserved activity is SRA regulated and non reserved activity is not subject to the provisions of the Handbook.

⁶ Phase one came into effect in October 2014 and made changes to the format of the accountant's report, introduced an exemption and removed the requirement for firms to submit reports where there were no rule breaches. Phase two was implemented in November 2015 and encouraged reporting accountants to apply an outcomes-based approach to assessing compliance. The SRA extended the exemption from the obligation to obtain an accountant's report to firms that have an average client account balance of no more than £10,000 and a maximum balance of no more than £250,000 over the accounting period.

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There are three main proposals:

1. The most significant and far reaching proposal is a **change to the definition of client money** - the SRA is proposing to allow money paid for all fees and disbursements⁷ for which the solicitor is liable (for example counsel fees) to be treated as the firm's money. Money held for payments for which the client is liable, such as stamp duty land tax, will continue to be treated as client money and therefore be required to be held in client account.

The SRA believes that the change in definition will remove the need to have a client account for some firms and therefore reduce the associated compliance costs. The changes may also reduce the number of firms required to obtain an accountant's report through the subsequent reduction in the client account balance.

Firms would still have to comply with obligations to keep client assets safe, however, the proposals do not contain prohibitions against accessing the monies. In the Society's response to the SRA's overseas accounts rules consultation in January 2015, we argued that, while removing the need for practices to comply with accounts rules would remove a regulatory burden, the SRA has not provided evidence that holding disbursements entailed less risk than holding other types of client money.

There may also be issues with accountancy software being updated. This could have a significant cost to firms to comply with.

2. **The SRA's proposed simplified rules** - the SRA anticipates that these will allow firms to have greater flexibility in order to manage their businesses. The SRA would also like to make the rules simpler and easier to understand which, it is hoped, will increase compliance and reduce compliance costs.

On the face of it, these changes appear simpler. However, less prescriptive rules may prove difficult to administer for both firms and accountants as they will create uncertainty as to whether a firm is compliant. The SRA proposes to provide an online toolkit which will comprise of guidance and case studies to aid compliance. It will be crucial that the toolkit is detailed enough in order to eliminate this very serious issue.

3. **The proposal to allow solicitors to use third party managed accounts (TPMAs)** - this is the second time that the SRA has consulted on allowing firms to use TPMAs. In 2015, the SRA agreed to postpone making a decision on this given significant stakeholder concern. **It is unlikely that many firms would opt to use third party managed accounts**, although there may be some to whom this would be attractive. The Society has concerns that there could be negative unintended consequences associated with this proposal. For example, if firms do decide to opt for third party managed accounts in large numbers, it could have implications for client protections such as the Compensation Fund if the SRA were to decide that these firms did not need to

⁷ See s67 of the Solicitors Act 1974.

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contribute. It is unclear whether professional indemnity insurance companies would offer improved terms for those using TPMA's. Furthermore, it would seem unlikely to eliminate determined theft.

Relevant SRA Consultation Questions

- Do you consider that the draft Accounts Rules (Annex 1.1) are clearer and simpler to understand and easier to comply with? (Q.1)
- Do you agree with our proposals for a change in the definition of client money? In particular do you have any comments on the draft definition of client money as set out in the draft Rule 2.1? (Q.2)
- Do you have any views on the use of credit cards to pay for legal services? If you are a firm, do you accept credit card payments? If not, why not? If you are a consumer, do you use a credit card to pay for legal services? If not, why not? (Q.3)
- Do you consider it appropriate that only client money (as defined in draft Rule 2.1) should be held in a client account? (Q.4)
- Do you agree with our proposal that mixed monies can be paid into client or business account as long as the funds are then allocated promptly to the correct account? In particular do you have any the new draft Rule 4.2 (see Annex 1.1)? (Q.5)
- Having regard to our proposed definition of client money, do you agree that we can safely dispense with the specific Accounts Rules relating to payments from the Legal Aid Agency (LAA)? (Q.6)
- Do you agree with our approach to allowing TPMA's as an alternative to holding money in a client account? (Q.7)
- If not, can you identify any specific risks or impacts of allowing TPMA that might inform our impact assessment? (Q.8)
- Do you consider it appropriate for TPMA's to be used for transactional monies – particularly in relation to conveyancing? Or should the use of TPMA be restricted to certain areas of law? If so, why? (Q.9)
- Do you have any views on whether we need to retain the requirement to have a published interest policy? (Q.10)
- Do you have any comments on the draft Accounts Rules, either as a whole or in relation to specific Accounts Rules? (Q.11)
- Are there other areas relating to the Accounts Rules that should be included in the toolkit for firms through guidance or case studies? If yes, please provide further details. (Q.12)
- Are there other areas relating to the Accounts Rules that should be included in the toolkit for firms through guidance or case studies? If yes, please provide further details. (Q.13)
- Is there any information, data or evidence that you can provide or direct us towards that will assist us in finalising our impact assessment? (Q.14)