E-Briefing Detailed Version
(Covering the period from 1-31 March 2010)

1. Professional Representation

1.1 Professional Rules and Regulation Committee

The Professional Rules & Regulation Committee ("PR&RC") responded to the SRA's consultation paper "Achieving the right outcomes" (See http://www.sra.org.uk/sra/consultations/consultations-closed.page for the consultation paper and http://www.citysolicitors.org.uk/FileServer.aspx?oID=763&lID=0 for the response).

As the consultation paper stated:

> **What is this paper about?**
>
> 1. This paper explains how the SRA intends to transform the regulation of solicitors and the organisations in which they work, and invites the engagement of consumer groups, the profession, and all those with an interest in legal services in the debate about how we deliver it.
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> 2. In essence, our approach is to deliver:
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> a. outcomes-focused regulatory requirements1 designed to give flexibility by avoiding unnecessary prescriptive rules on process, while giving clear guidance on what it is that firms must achieve for their clients;
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> b. an approach to the supervision of firms that helps firms achieve the right outcomes for clients, and that encourages firms to be open and honest in their dealings with us;
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> c. a high quality desk-based research and analysis capacity to assess the potential risks to the regulatory outcomes, supporting and leading the SRA's delivery of evidence-based and risk-based, proportionate regulation;
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> d. enforcement action which is prompt, effective, proportionate and creates a credible deterrent against failure to act in a principled manner.

The Committee's response stated:

> We would welcome a radical change to your current approach to the regulation of legal services; many of our key concerns have been rehearsed previously in response to the calls for evidence from Nick Smedley and Lord Hunt, and indeed in our previous responses to various SRA consultations.
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> We are keen to support you in developing a new principles-based, outcomes-focused, code.
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> We broadly agree with your proposed approach to supervision and enforcement. In this regard we would like to note the discovery visits undertaken in late 2008/early 2009 when the SRA engaged with a number of our member firms; following these visits, in the summer of 2009 we had anticipated receiving proposals on the future approach to supervision of the corporate sector which did not materialise. We would like to understand how this work will feed into this current initiative and are concerned that the new series of pilot visits may be going over ground that has already been covered by your staff.
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> We believe that a new code will not of itself move regulation in the direction you and our members wish unless there are similarly radical changes in the culture, expertise and practices of the regulator which reflect the new approach, in particular amongst those charged with the tasks of supervision and enforcement. We are very pleased to see this acknowledged in the paper.

An early test of the commitment of the SRA to radical change will be your approach to consulting on, and drafting, a new code. We are anxious to ensure that our members' attempts to help you move forward are valued and reflected in your work. As your proposals are the most radical yet put forward by the SRA, we would encourage you to engage with stakeholders individually at the earliest opportunity so that the final code reflects fully the view of the widest spectrum of opinion.

With this in mind, we would invite you to meet representatives of our members to discuss your ideas and ours before setting out on the task of preparing any document which attempts to codify the principles, evidence of compliance and guidance. There have been occasions in the past when we have felt that our responses to consultations have not been reflected in the final outcome, and we have been given little or no explanation as to why our carefully considered points have not been adopted.

Given the critical import of this initiative and the scale of the task it is vital to ensure the outturn is properly considered and the best which can be achieved for all stakeholders. We note with some concern the tight timeline being proposed overall, and that a further consultation document is to be issued on the new approach in March notwithstanding that the deadline for responses on your January paper is 6 March which leaves little time to properly digest responses.

The key to the success of the new approach will be to draft a code which strikes the correct balance between the law, principles, evidence of compliance and guidance. This in turn depends for its successful application on the formulation of an approach to supervision and enforcement which properly reflects deep understanding of each sector of the profession, the firms in that sector and the sophistication and needs of the clients they service.

There will be an obvious temptation to put the bulk of the current rules into the evidence of compliance category which should be resisted. Before including a provision under the evidence of compliance category, the SRA must believe that the provision should be complied with by all legal service providers other than in exceptional circumstances; simply having a sophisticated client should not be regarded as exceptional. Nor would vague and undefined references to situations where it can be "demonstrated that it was inappropriate in the circumstances to meet some or all of these requirements" resolve our concerns.

Example 1 in your paper serves to illustrate our concern. Some of the "examples" here whilst entirely appropriate when dealing with an unsophisticated private client are entirely unnecessary, in some cases irrelevant, when dealing with sophisticated corporate clients. For example, "giving the client the name of the person responsible for the matter in writing", or "explaining your responsibilities and those of the client". If these points remain as evidence of compliance (failure to undertake which would be taken by the SRA as indicating a prima facie breach of the code), then firms will continue to expend resources on complying with what will be regarded as "rules" rather than risk a breach, and the outcomes for clients will not change in any way.

Our strong preference would be for the evidence of compliance to be set at a high level where it will have almost universal application; with the details of what this means in practice for different types of client or firm being dealt with in the non-mandatory guidance. Setting the right balance between guidance and evidence of compliance will be challenging, but it is the key to the success of this project, which accepts that one size fits all is entirely inappropriate for the diverse profession the SRA seeks to regulate. If the right balance is achieved this will deliver immense flexibility and facilitate future development through the guidance alone, without the need to revise the substance of the code itself. We believe that our and your time would be well spent considering the underlying needs of clients and firms in all sectors of the legal market before attempting to translate these into a code; we would be very keen to meet with you to develop these ideas.

We are also keen to ensure that the new code takes into account commercial considerations and, in particular, that a proper balance is struck between consumer protection and unnecessary intervention into the way firms manage their affairs. We see a distinction which must be drawn between matters of service and professional conduct, and matters of a purely commercial nature between clients and legal service providers. At present, the existing code contains some provisions which disadvantage legal service providers in normal commercial relations. An example would be the recent changes to rule 2 as a result of the repeal of remuneration certificates, and which extend the complaint handling provisions to cover bills; some of our members have already

had experience of sophisticated commercial clients embracing the opportunity to delay resolving disputes by using the complaints "system" in a cynical manner.

We await with interest the consultation paper on the new approach to enforcement, as this will be of critical importance to the success or otherwise of your proposed new approach.

We note that there is no detailed reference to the Smedley reforms. To what extent will the new approach reflect the Smedley proposals?

2. Specialist Committees

2.1 Company Law

The Company Law Committee of the Law Society of England and Wales and the City of London Law Society Company Law Committee responded to the Financial Reporting Council "Consultation on the Revised UK Corporate Governance Code ("The Code")". (See http://www.frc.org.uk/images/uploaded/documents/Consultation%20on%20the%20Revised%20Corporate%20Governance%20Code1.pdf for the consultation paper and http://www.citysolicitors.org.uk/FileServer.aspx?oID=764&lID=0 for the response.)

As the consultation document stated:

> **INTRODUCTION**
> During the course of 2009 the Financial Reporting Council (FRC) has carried out a review of the impact and implementation of the Combined Code, the results of which were published in December. The main findings of the review are set out in "2009 Review of the Combined Code: Final Report"
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> ...As a result of the review the FRC is consulting on a number of changes to the Code.
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> ...Subject to the outcome of this consultation, the intention is to publish the revised Code in April or May 2010.

The paper also mentioned that the FRC intended to introduce changes to the structure and content of the Code, including to the main principles, provisions and disclosure requirements.

The response stated:

> The joint committee is broadly supportive of the approach of the proposed changes. We do not propose to comment on questions of policy but confine our comments to legal and practical implementation of the proposed changes.

The response made specific comments under the headings:

1, Long term success
2. Role of directors
3. Board re-election
4. Business review requirements
5. Overseas companies

2.2. Financial Law Committee

The Financial Law Committee responded to the discussion paper issued by the Ministry of Justice entitled "European Commission Review of Article 14: Assignment". (See

http://www.citysolicitors.org.uk/FileServer.aspx?oID=778&lID=0 for the response.) As the discussion paper stated:

> **Executive Summary**
> The subject of this discussion paper centres on the conflict of laws (choice of law) as it applies in the difficult area of assignment of claims. Article 14 of the Rome I Regulation already deals with some aspects of this matter, but it does not deal with them all.
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> The issues covered by Article 14 are:
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> - rights between an assignor and an assignee, which are governed by the law governing the contract of assignment (referred to later in this discussion paper as "***paragraph-1 issues***"); and
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> - rights and obligations of the debtor, which are governed by the law governing the contract creating the claim to be assigned (referred to later in this discussion paper as "***paragraph-2 issues"***).
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> These issues are explained further in **paragraph 8** of this paper.
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> The issues not covered by Article 14 of the Rome I Regulation (referred to later in this paper as "***paragraph-3 issues"***), and the subject of a review to be carried out by the European Commission, are:
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> - the effectiveness of an assignment or subrogation of a claim against third parties; and
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> - the priority of the assigned or subrogated claim over a right of another person.
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> These issues arise in relation to the position of "*third parties*", by which is meant persons other than the assignor, the assignee and the debtor.
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> The first question that this raises is "*what law should apply to* ***paragraph-3 issues***?" The provisional view of the Government is that ***paragraph-3 issues*** should, like ***paragraph-2 issues,*** be governed by the law governing the contract creating the claim to be assigned. The reasons for this are explained further in **paragraphs 11-21** of this paper. However, there will probably have to be exceptions with regard to factoring and consumer contracts – see **paragraphs 22-23**.
> Special problems also arise in relation to:
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> - judgment debts;
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> - intellectual property;
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> - shares in companies;
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> - letters of credit;
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> - insurance policies; and
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> - the assignment and subrogation of claims in tort or delict (important in respect of insurance)
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> There may also be problems in respect of some aspects of transferable securities other than shares. In all these cases, two questions arise: "*should the Regulation apply to the matter and, if so, should the matter fall within the general rule or should it be subject to a special rule*?

The Committee's submission responded to the following questions:

> ***United Kingdom compromise***
> **Q1.** Is the general scheme of the proposed solution satisfactory?
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> ***Judgment debts***

Q2. Should there be a rule that the assignment of judgment debts is governed by the law of the court that granted the judgment; and should this apply to ***paragraph-2 issues*** as well?

Intellectual property
Q3. Should special provision be made for assignments of intellectual property? If so, should the applicable law be that under which the IP right arose or was created? Should this apply to ***paragraph-2 issues*** as well?

Shares
Q4. Should special provision be made for assignments of shares in companies? If so, would it be satisfactory to apply the law governing the share agreement, normally that of the habitual residence of the company? If so, should there be a further exception to the proposed ***paragraph 3(b)*** under which shares are also excluded from the rule in that paragraph?

Letters of credit
Q5. Is it necessary to make special provision for letters of credit? Should letters of credit be excluded from the rule in ***paragraph 3(b)?***
Q6. Should there be a further exception to the proposed ***paragraph 3(b)*** under which insurance policies are also excluded from the rule in that paragraph?

Tort or delict claims
Q7. Should the proposed ***paragraph 3*** apply to the subrogation (both by operation of law and under a contract) and assignment of claims in tort or delict? If so, should the applicable law [be] determined by the general rules or is special provision necessary?

In addition, the Financial Law, Insolvency Law and Regulatory Law Committees all responded to the HMT consultation paper "Establishing resolution arrangements for investment banks". (See http://www.hm-treasury.gov.uk/consult_investment_banks2.htm for the consultation paper and http://www.citysolicitors.org.uk/FileServer.aspx?oID=777&lID=0 for the Financial Law Committee's response and http://www.citysolicitors.org.uk/FileServer.aspx?oID=776&lID=0 for the Insolvency Law Committee's response.) The Insolvency Law Committee responded to Chapters 2, 5 and 8 of the Consultation Paper, and the Regulatory Law and Financial Law Committees' responses covered the remaining sections.

The consultation paper stated:

> The Government published a discussion paper in May of this year, outlining its initial thinking on the steps necessary to improve the regime around the failure of investment firms. Since then, it has engaged in an extensive process of consultation with industry experts, including buy- and sell-side firms, insolvency practitioners, and legal experts. The Government has also worked closely with the Bank of England and the Financial Services Authority (FSA) to develop balanced and proportionate policy outcomes.
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> This consultation document provides further detail on the Government's thinking, and outlines a package of more than 30 policy initiatives designed to mitigate the impact of the failure of an investment firm.
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> The core of these proposals, as set out in Chapters 2 and 3, is a set of measures to enable the managed wind-down of an investment firm. These include the development of resolution plans for firms, a set of special administration objectives and new responsibilities to be placed upon the board. These resolution proposals underpin specific initiatives designed to achieve better outcomes for key groups affected by the failure of an investment firm. These aim to:
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> - speed up the return of client money and assets (Chapters 4 and 5);
> - address counterparty exposures to the firm (Chapter 6); and
> - ensure creditors are sufficiently protected (Chapter 7).

These proposals are designed to operate together as part of an integrated package of reforms.

They respond to the specific challenges highlighted by the collapse of Lehman, but are also designed to be forward looking, and place the UK on a strong footing to deal with any future failure of an investment firm. They should not be seen in isolation; the policies laid out in this paper form a key part of the Government's broader financial sector reform agenda laid out in the *Reforming Financial Markets* White Paper.

Enabling an orderly resolution
Chapters 2 and 3 of this paper set out policies to ensure that an investment firm can be wound down effectively with limited impacts on financial markets. These measures are designed to enable continuity across the operations of a firm at both a pre- and post-insolvency stage; and to ensure that key systems remain operational at the point at which the firm fails.

Chapter 2 lays out proposals for a new administration regime for a failed investment firm. This would ensure that the administration of a failed firm is conducted with due regard to financial stability and the proper functioning of markets, as well as with reference to the need for the speedy recovery of assets for clients and counterparties of the firm.

...Chapter 3 builds on work HM Treasury, the FSA, and the Bank of England have initiated on recovery and resolution plans for individual firms.

...Chapter 4 sets out proposals to improve the protections for investment firm clients at a preinsolvency stage.

...Building on these proposals, Chapter 5 sets out the Government's proposals for the possible creation of the position of a client assets trustee.

...Chapter 6 sets out proposals to mitigate the impact of investment firm failure on the market counterparties of the firm. The proposals in this chapter are designed to improve the functioning of market infrastructure in the event of an investment banking failure.

...Chapter 7 considers the impacts of the policies outlined above on the unsecured creditors of a failed firm. It also discusses possible changes to the International Swaps and Derivatives Association (ISDA) Master Agreement and options for risk management resource centres to support administrators.

...Chapter 8 discusses the international context in which the proposals described in this paper are to be taken forward. It sets out the Government's high-level principles for further cooperation with our international partners to ensure effective treatment of cross-border investment firms.

The Financial Law Committee's response stated:

There are in all three submissions from CLLS Committees expressions of concern about an over-heavy reaction to the recent crisis and the failure of Lehman, which risks imposing very heavy burdens on market participants. There are a large number of other complex regulatory measures in the pipeline. We urge that a "proportionality" review is carried out before introducing measures, particularly those of a regulatory nature, to ensure that they do not impose undue or unnecessary burdens or cause confusion and that they do not un-necessarily affect competitiveness of firms in the market place or curtail access to the market.

Importantly, we consider that many of the issues addressed are not unique to investment banks. The issues relevant to the Lehmann insolvency are in many cases a result of the factual situation and only to a limited extent capable of improvement through a legislative means. Of these a special insolvency process appears less important than addressing the confusion that the courts have found in the FSA rules and in ensuring that record keeping requirements are appropriate.

One of the key benefits of the English legal system, which we believe is shared by its general insolvency laws, is the flexibility of those systems to deal with difficult and changing situations. We recommend therefore that care is taken not to disturb that flexibility.

> We note that the CLLS Insolvency Law Committee considers that a strong case needs to be made before any new insolvency procedure or modified insolvency procedure is introduced. There are now over 20 "special" insolvency procedures in the UK. For the reasons stated by that Committee we very much support a "light touch" approach to any modifications to the existing administration regime for an insolvent investment firm. We consider, however, that the proposed special objectives would provide clarity and transparency both for the administrator and the counterparties as a variation of the standard objectives in an administration and would support their introduction in the case of administration of an investment bank (or indeed more generally for businesses holding third party assets). This might be better done by amendment to the Insolvency Act than by creating a special regime. As regards the proposals for a bar date for client asset and client money claims, we are strongly of the view that these would be a useful modification to the insolvency legislation, but applicable in all cases where third party assets are held by an insolvent business, not just investment banks, and should operate to bar proprietary claims not only against the company and its administrator/liquidator, but also against any third party to whom assets are distributed.
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> We also agree with the views of the Insolvency Law Committee that, rather than lowering the standard of care for an administrator's duties (or attempting to come up with an alternative formulation for the standard of care), an administrator will be sufficiently protected if his duties are linked to the pursuit of the special objectives.
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> We, like the Insolvency Law Committee and the Regulatory Law Committee, are very concerned about the proposals in Chapter 5 of the Consultation Paper and, in particular, the proposals for the appointment of the Client Asset Trustee (**CAT**). We consider that these proposals are likely to add to the cost and complexity of the administration without giving rise to any real benefit. To have separate officeholders appointed in respect of the client assets and the general estate would inevitably lead to duplication and potentially litigation regarding the respective roles. We strongly urge the abandonment of these proposals.
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> On the cross-border side, we believe that there is no easy answer to the cross-border issues and ultimately we suspect that the UK Government can only legislate for UK firms while monitoring closely the international developments referred to in Chapter 8 to ensure that the UK proposals are not inconsistent with these developments, as well as participate in international discussions to seek to achieve maximum harmonisation, whether at EU level or through other international treaties.

2.3 Insolvency Law Committee

The Insolvency Law Committee responded to the HMT consultation paper "Establishing resolution arrangements for investment banks" (as above). (See http://www.citysolicitors.org.uk/FileServer.aspx?oID=776&lID=0 for the response.)

2.4 Regulatory Law Committee

The Regulatory Law Committee responded to the HMT consultation paper "Establishing resolution arrangements for investment banks" (as above). The Committee also responded to the FSA's consultation paper "Delivering the Retail Distribution Review: Professionalism; Corporate pensions; and Applicability of RDR proposals to pure protection advice (CP 09/31)". (See http://www.fsa.gov.uk/Pages/About/What/rdr/index.shtml for the consultation documents and http://www.citysolicitors.org.uk/FileServer.aspx?oID=773&lID=0 for the response.) As the FSA documents stated:

> The RDR is seeking to rebuild people's trust and confidence in the retail investment market by raising standards of professionalism. A key element of the FSA's wide-ranging reforms is that by the end of 2012, advisers, whether independent or restricted, will need to demonstrate greater knowledge and skills and meet enhanced standards in dealing with clients.
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> The FSA is proposing to create a new in-house governance structure to ensure advisers achieve this greater level of professionalism, both initially and on an ongoing basis through the achievement

of new, higher level qualifications; meeting enhanced standards of continuing professional development; and adhering to common ethical standards.

This streamlined approach fits with the FSA's existing role in approving and supervising investment advisers, and would enable the FSA to apply its more intensive supervisory approach, including its greater focus on individuals in key positions, to the retail investment advice sector. At the same time, the FSA is proposing that professional bodies, registered with and overseen by the FSA, should play a greater role in helping their members meet its new professionalism requirements.

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