THE CITY OF LONDON LAW SOCIETY

Legal Services Act: New forms of Practice and Regulation

Consultation Paper 6: Client Financial Protection

The City of London Law Society (***CLLS***) represents over 13,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi jurisdictional legal issues.

The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees. This response in respect of the SRA's consultation regarding client financial protection has been prepared by the CLLS Professional Rules and Regulation Committee. This response is set out below in relation to the questions and numbering as they appear in Consultation Paper 6.

As a general, introductory point, we note that the Paper does not include any analysis of the likely cost to SRA regulated persons of the SRA accepting the default regulator role or indeed any quantitative analysis at all. Cost analysis at a minimum is essential. No informed decision can be made without understanding the financial implications of acting as a default regulator in the same way that no decision can be made without the views of other regulators being made known.

1. **Do you agree that individual solicitors (Category A), and individual RELs and RFLs (Category B) who are engaged in private practice, should continue to be covered by compulsory professional indemnity insurance through their firms?**

   We agree with this approach

2. **Do you agree that the compulsory professional indemnity insurance requirement should apply to all firms authorised by the SRA (Category C)?**

   We agree with this approach

3. **Regarding unauthorised firms that only the SRA can authorise (Category D), do you think:**

   (a) **The SRA should reject the role of default regulator so that the compulsory professional indemnity scheme does not cover unrecognised partnerships/sole practitioners (paragraph 19, D1); or**

   (b) **The SRA should adopt the role of default regulator in that the protection afforded by the compulsory professional indemnity scheme applies to partnerships and sole practitioners whether recognised or not (paragraph 19, D2)?**

   We feel strongly that the SRA should reject the role of default regulator in respect of firms that have not sought to be authorised by the SRA (whether this is done deliberately or negligently). There is no good reason to follow the current operation of the scheme in the context of the new regulatory framework.

The SRA perceives that clients will (or the LSB may) expect it to have the power to provide financial protection in relation to unrecognised partnerships and unrecognised sole practitioners and that it is therefore preferable for this to be the situation. We do not believe that this expectation will exist nor, even if it did so, that this would be a reason to choose option D2. Certainly we do not think that it is appropriate to devise a regulatory strategy based on seeking to second guess the opinions of a body that has not yet been constituted.

The critical factor, we believe, is that we are moving to a multi-regulator environment, an explicit purpose of which is to provide choice and price competitiveness for consumers. It is fundamental to the success of that initiative that consumers are capable of making (and will make) informed decisions between competing providers of equivalent services on the basis of a number of factors including price, service and regulatory oversight.

Much of the thrust of reform would be lost were the SRA to take the view that it should continue to underwrite the activities of unrecognised firms in the way that it did in the past. Such an approach undermines the regulatory objective of promoting competition in two ways. First it removes from those who are recognised by the SRA the ability to convey to potential clients that having the SRA regulate the business provides longstop financial protection for clients and as such is a differentiator. Secondly, and crucially, it would involve those who are recognised by the SRA shouldering the costs associated with unrecognised entities. In a competitive market for legal services this will push up the cost base of recognised providers of legal services against not just unrecognised providers but also providers of equivalent services regulated by other regulators who do not accept an equivalent default regulator position. If there is no compensatory distinction in the mind of consumers (because all firms that could be recognised are equally underwritten), the effect will be to create an unjustifiable competitive disadvantage.

4. **Regarding unauthorised partnerships/sole practices that can be authorised by the SRA or another regulator (Category E):**

   (a) **Do you think that the SRA should reject the role of default regulator so that the protection forwarded by the compulsory professional indemnity scheme applies to recognised bodies and recognised sole practitioners only (paragraph 20, E1)?**

   (b) **If you believe that the SRA should adopt the role of default regulator, should that be on the basis of: accepting it in all Category E cases (paragraph 20, E2); confining cover to the personal liabilities of those individuals we authorise (paragraph 20, E3) or accepting it only in those cases where the partnership is dominated by individuals we authorise? (paragraph 20, E4)**

We believe that the SRA should reject the role of default regulator (option E1). To give effect to the principle of firm based regulation, the SRA should only act as the default regulator where the entity as a whole is recognised.

To adopt the position of default regulator in all cases (option E2) would (as the SRA itself notes) impose on those who accept regulation by the SRA the burden of the costs associated with client protection for Category E entities as a whole, but without any certainty that these costs will be shared equally (or even at all) by those who are

subject to the control of other regulators. We believe that this is manifestly unreasonable.

We would argue that the question of the default regulation of entities that comprise individuals authorised by more than one FLR (options E3 and E4) can only be answered as a result of dialogue between the relevant regulators and not in the abstract. We do not think that it is appropriate to accept this significant burden, at the SRA puts it, "in the hope that other approved regulators would then adopt a similar approach".

Even if other regulators were to be interested in the concept of being a default regulator, there is no certainty that they would adopt a complementary approach to the one which the SRA had itself chosen. For example, in relation to option E4, the SRA suggests two tests (the majority test and the largest group test) but an equally (if not more) valid test would be a control test (i.e. which regulated individuals direct the management of the entity?). Suppose that such a test was applied by the Council for Licensed Conveyancers. How would financial protection work where an entity was managed by solicitors but employed a majority (or largest single group) of licensed conveyancers? Ostensibly in that case neither FLR would be the default regulator.

We would reject option E3 for the reasons the SRA itself sets out in that section.

5. **Do you agree that firms that are authorised by another regulator should be excluded from our compulsory professional indemnity scheme? (Category F)**

Yes, it would be entirely unreasonable to extend the Scheme to those firms.

6. **Do you agree that unauthorised firms that cannot be authorised by any regulator should be excluded from our compulsory professional indemnity scheme? (Category G)**

Yes, for the reasons the SRA sets out in paragraph 22.

7. **Do you believe that the Compensation Fund should continue to be available in the last resort for claims in respect of a solicitor's dishonesty, even if the solicitor is practicing in a firm authorised by another regulator?**

No, in a competitive market for legal services consumers should have access to the protection established by the regulatory regime applicable to the category of legal services organisation with which they contract.

As a related but more general point, we believe a significant downside of extending the default regulator position too widely (with its associated cost burden) would be a weakening of the attraction of being an SRA recognised firm with its 'stamp of approval'. In a worst case, this would lead to a reduced number of recognised partnerships/sole practitioners carrying the insurance costs of those entities to which default regulator protection is applied.