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Dear Sirs

Response of the CLLS Professional Rules and Regulation Committee to the SRA's consultation on the Separate Business Rule (the "Consultation")

The City of London Law Society ("CLLS") represents approximately 15,000 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 specialist committees. This response to the Consultation has been prepared by the CLLS Professional Rules and Regulation Committee.[1]

We acknowledge the context in which the Consultation proposals have been promulgated. The unregulated legal services sector is already permitted and growing. Alternative Business Structures ('ABS')'s established by non-lawyers are being granted waivers of the Separate Business Rule, although we would submit that is principally a result of their key investors already undertaking business activities which happen to fall within the scope of prohibited separate business activities, as opposed to indicating market demand for change, and could have been foreseen. The Government has confirmed that it has no appetite to legislate to change the Legal Services Act 2007 ('LSA') or to review its list of reserved activities.

We do not necessarily have appetite for an approach which mandates the SRA regulating all solicitors' reserved and non-reserved activities. As we stated in our response to the SRA's MDP Consultation, we consider the time is ripe for a systematic and risk based review of solicitors' activities, holistically. Our informal discussions with the SRA in the context of this consultation lead us to conclude that the SRA agrees with us that there is no correlation between 1. reserved/non-reserved actions and 2. low/high risk.

[1] A list of the members of the CLLS Professional Rules & Regulation Committee can be found here: http://www.citysolicitors.org.uk/index.php?option=com_content&view=category&id=151&Itemid=469

Furthermore, we appreciate the logic which informs the SRA's approach in the Consultation. Against the backdrop of the expanding unregulated sector and ABS waivers, some other regulated professions, including chartered accountants, which can participate in ABSs, do not have separate business rules. If anyone can set up an unregulated legal services business, the restriction on authorised persons having links to them, begins to appear arcane.

However, we consider the proposal to remove the Separate Business Rule and replace it with specified Outcomes is overly hasty, not based on sound data and has been made without a proper assessment of the likely impact, which we consider in the short term, if the proposal is implemented as drafted, may lead to a splintering and destabilisation of the profession and damage to the solicitor brand, at home and overseas.

The Consultation proposal involves the SRA permitting authorised persons to hold limited and passive investments in unregulated legal service providers. The paradox is that solicitors, many of whom are likely to be the most qualified and experienced providers of non-reserved services (including legal advice) in the market, are (with barristers) the only group of persons who will be prohibited from practising in their own separate businesses. In this, the SRA's response is logical but lacks follow through.

If the goal is a level playing field, the proposal should promote change to the Practice Framework Rules and permit solicitors to own, and practise in, unregulated legal service businesses, with the risks of consumer confusion being managed by clear signposting. That is likely to be in consumers' best interests as their unregulated sector service provider options will then include qualified and experienced professionals, with a thorough grounding in the English legal tradition and system. Permitting solicitors to flow across the previously impermeable 'wall' into the unregulated sector should act to drive up standards there. If the Consultation response needs to be delayed to permit further consultation on relaxation of the Practice Framework Rules, we suggest that is a sensible measure, thus permitting avoidance of an awkward 'half way house' solution.

At first glance, City and other large firms may be best placed to benefit from the Consultation's proposal as they are likely to undertake the highest percentages of non-reserved activities[2]. From a risk based perspective, they arguably already have the infrastructure properly to manage their non-reserved activities, having sophisticated client bases and established risk management and governance systems.

Some may avail themselves at an early stage of the opportunities offered by the new flexibility; others may be wary about hiving off work to unregulated separate businesses for a range of factors, including:

- concerns around how such work will be properly supervised and managed, if solicitors cannot themselves practise in the separate business;
- issues with the proposed new referral outcomes and proposals relating to use of brand, on which we comment further in our detailed response to your Question 2 below;
- unwillingness to cede the client's legal professional privilege;
- uncertainty as to the operation of conflicts rules on the recognised body in relation to clients of the separate business;
- uncertainty as to the operation of the Proceeds of Crime Act and, in particular, whether or not communications between the recognised body and the separate business might in some circumstances constitute improper "tipping-off";

[2] See comments in the first bullet point on page 3 of this response.

- reluctance on the part of long serving professionals to slough off their 'solicitor' titles and pick up roles in the unregulated sector as 'lawyers'; and
- depending on how firms with international offices are structured, reluctance or inability (due to overseas bar rules) on the part of overseas or foreign-qualified members/partners in the recognised body, to participate in organisations which invest in or share fees with entities which offer unregulated legal services. In particular, overseas or foreign qualified members/partners might be prohibited under overseas bar rules from sharing privileged or confidential client communications with a separate business operating outside the legal profession.

If (when?) competition from new entrants to the unregulated sector (who may be private equity backed and well-funded, governed and insured) or from other professionals, who are not subject to continuing restrictions on how they can participate in the unregulated legal services sector, starts to bite, reluctant acceptors may be driven to come to terms with the above reservations and/or artificially to restructure, for example by English and Welsh members of a Verein structure setting up a mirror structure, which does not include overseas partners, specifically to invest in a separate business.

The key issue with the Consultation's proposal is that solicitors, many of whom, particularly in the City, undertake only non-reserved activities via the provision of legal advice, will remain unable fully or actively to participate or practise in the unregulated sector. If (when?) clients start choosing players in that sector as the premier providers of non-reserved legal services, competition may drive solicitors out of the regulated sector and off the roll, to practise instead in the new world as 'lawyers' with the SRA (and the Law Society) experiencing a consequential (and potentially significant) decline in clout and revenue. The ultimate concomitant of the SRA deregulating to open up provision of legal advice by separate businesses, is that legal advice will, sooner or later, stop being a 'solicitor service'. Solicitor services may shrink to becoming those services which only solicitors can provide, i.e. reserved activities.

Whether that is good or bad is a moot point but we would submit that the SRA should not press ahead with these changes, without acknowledging the core role of legal advice in the services which many solicitors provide and the impact of making changes which permit solicitors only to invest, but not start providing that legal advice, in the unregulated sector.

The Consultation Questions

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

Given the potential, far reaching implications for the solicitors' market and brand of your proposals, the market analysis on which they are based, is surprisingly unscientific and not bespoke (i.e. not prepared specifically for the Consultation). You may recall that we made similar comments in our response to the MDP consultation in which we called for a systematic risk analysis of the reserved and non-reserved sectors, which recommendation appears to have been overlooked. In our view, this is a missed opportunity and more time for research and consultation should have been allocated, prior to the SRA recommending changes in this complex area.

Annex 1 to the Consultation represents a series of findings, pulled together from various sources, which:

- crucially fails to flag the conclusion of the (public domain) report of Charles River Associates, prepared for the LSB and entitled 'Benchmarking the supply of legal services by City law firms' (to which we also referred in our MDP Consultation response) that: 'On the basis of educated guesses, most [City] firms estimated that the proportion of work that involved reserved activities would probably be less than one quarter';
- indicates that 'private client work tends to be clustered around the reserved and closely related activities (conveyancing, probate, estate administration and family)', thereby overlooking the swathes of wealth structuring and tax advice provided to private clients in the non-reserved sector, particularly by Top 100 and City firms; these may be sophisticated and high net wealth clients, often entrepreneurs, who run their own significant corporate enterprises or who may have founded listed business, such entities also potentially being clients;
- relies on Legal Ombudsman data as evidential without taking into account that sophisticated corporate clients receiving non-reserved legal advice will have no redress to the Legal Ombudsman; and
- refers to regulatory action by the SRA, but which may also not yield relevant data, as complaints and service issues in City firms tend to be managed, quickly and efficiently, by in-house dedicated client service teams.

Furthermore, much reliance is placed in the Consultation's proposal to remove the Separate Business Rule, on the fact that this formalises 'what is being implemented by waivers in a significant number of cases'. However, the 60 waivers granted to ABSs appear principally to have been requested as a result of the ABS' investing owner, already undertaking an activity which happens to be a prohibited separate business activity, meaning the waiver is technically required, once the new ABS gains a link (to its parent) on inception. There is little evidence of a call by traditional law firms for waivers of the Separate Business Rule; only two have been granted.

The need for waivers in these circumstances should and could have been foreseen by the SRA and should not be being interpreted as 'an indication of a mis-match between SRA and market development'.[3]

On the subject of findings extrapolated from data, we find the conclusion [4] that; 'if overall regulatory income from turnover reduces as a result of non-reserved legal activity moving into separate businesses, then the necessary costs of regulation could be recouped by increasing the percentages charged on turnover and/or by increasing individual practising fees', not to be compelling. If work is hived off to the unregulated sector, so will the SRA's concomitant need to regulate and the associated cost of regulation must surely (albeit not necessarily proportionately) decline.

2 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?

This is the big question, addressed in the preamble to this response. We would submit that lifting the ban should only happen in conjunction with a thorough review of the Practice Framework Rules.

We would further comment that the proposals around use of brand are confused and do not reflect the fact that the separate business will be a subsidiary of the authorised person. Paragraph 10 of the

[3] Pp.37 of the Consultation

[4] Pp.119 of the Consultation

Consultation states that 'authorised persons will not be able to use their reputation as a regulated entity to gain a client's instructions for a particular case, only then to hive the case off to an unregulated separate business.' There is an emotive statement in paragraph 108 of the Consultation that 'the separate business has to stand on its own two feet.'

However, the brand of a City firm will be likely to have evolved from its provision of consistently excellent client service, demonstrable business success and market evaluation. Its regulated status may be only a small contributory element to brand. When the City firm first sets up its separate business and seeks clients for it, how and why should it be expected to shed its brand? Indeed, the new outcome requires that the client 'has been informed of your connection to the separate business'. Firms must also be untrammelled in the maintenance and development of their (single) brands across all group entities. It is unrealistic and not consistent with best business development practice to expect the brand of the separate business to differ from that of the authorised person which owns it. Indeed, if and when City law firms and their solicitors start working in the unregulated sector, their brands and continuing client demands are likely to ensure a consistent quality of service across their regulated and unregulated components.

A further issue is how the authorised person setting up the separate business will play a (necessary) managerial or supervisory role in it, given that solicitors are prohibited from practising in separate businesses. That prohibition in itself appears to contradict the new proposed outcome, which contemplates an authorised person 'actively participating in' a separate business. How will control be leveraged over the separate business? Presumably the SRA accepts that a City firm, say with 100% solicitor partners/members, will want to have one or more of these partners on the board of its separate business subsidiary. Presumably management inputs will not count as 'practising'. But will the non-reserved legal advisory components of clients' matters be capable of being effectively supervised by non-qualified staff in the separate business?

Much of the mainstream work (e.g. corporate and M&A) work of City firms, undertaken by solicitors, including partners, is non-reserved so firms may face a stark choice, if they go the separate business route, either to hive off just the support aspects and keep the bulk of the (non-reserved) work in the recognised body or for teams of well qualified and experienced trusted advisors to come off the roll and continue providing client services as 'lawyers' in the new structure. The opportunity for a full hive down of all non-reserved work is not there.

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

The only services which solicitors can (pending change to the Practice Framework Rules) provide to clients in a separate business are non-practising services. If the SRA accepts that solicitors can practise in ABSs, which conduct non legal work, and public confusion (including as to available client redress) can be managed by proper signposting, why should not solicitors similarly practise in unregulated separate businesses?

We consider the proposed 'non practising solicitor' hold out prohibition is unworkable. The SRA cannot prevent either solicitors who are on the roll, but undertaking non legal work in separate businesses, or

solicitors, who have come off the roll and who are providing legal services in separate businesses, holding themselves out as ‘lawyers’ or (in the latter case) as ‘former solicitors’.

Indeed, the term ‘former solicitor’ may become a badge of honour, indicating the modern legal advisor, who happens to have had a professional background and training, but who has elected to practise in an unregulated sector entity, incidentally not subject to the SRA charge on turnover and which may field flexible, self-imposed and best practice risk management and governance.

Many City firms employ overseas qualified staff, who are held out as ‘lawyers’. Their clients are already familiar with that brand and are likely to see it as equivalent to the solicitor brand. This proposed restriction may simply promote use of the ‘lawyer’ moniker.

If, however, solicitors are eventually permitted to practise as such in the unregulated sector, we would support their being subject to some form of lighter touch personal regulation which could include mandating clear signposting around available client redress, compliance with the principles and maintenance of ‘adequate’ professional indemnity insurance.

4 Do you agree with our proposals to prohibit some specific referrals that split matters involving or related to reserved activity?

Your proposals involving split matters can be by-passed by ensuring the separate business which undertakes estate administration, conveyancing administration or litigation support, as relevant, is the primary brand repository and the entity by which clients and their matters are first incepted, such that referrals only ever run from it to the regulated entity, providing the associated reserved activity.

The nub of the issue is one of consumer confusion and we would suggest that is better managed by an outcome, not premised on where clients happen to go first for services, but on requiring that where any part of the service is being provided by an unregulated separate business, that the client is made aware of what parts of the service are thus being provided (already in the draft Outcome) and specifically that, in relation to such services, the client will not have recourse to the Legal Ombudsman or the Compensation Fund, or the benefit of legal professional privilege or compulsory professional indemnity insurance, (which would require Chapter 12 to be bolstered). It could also be mandated that any differences in professional indemnity insurance cover, available to the separate business and the authorised person, should be similarly spelled out, although we suspect that large firms which elect to establish separate businesses and hive down to them significant parts of their businesses, will elect to maintain common insurance cover, levels of which are already driven by e.g. clients as opposed to the Minimum Terms, across both entities. Incidentally, by the same token they are likely to act to ensure continuing lawyer competencies.

The SRA should have no issue with managing these issues via signposting, given that it already accepts that solicitors can work in licensed bodies (ABSs) which undertake non legal activity, which is not regulated by the SRA, without consumer confusion.

5 Should further specific bans on referrals be included or would a general outcome such as that described in paragraph 113 be more appropriate?

We do not understand the outcome described in pp.113 viz that an authorised person is prohibited from dividing a client's matter between them and a separate business in a way that means that the client does not have the regulatory protections available to an authorised body.

If the recognised body sets up the separate business, at some level, whether simply via its ownership and management interests in the separate business, it is going to be involved with the dividing up of work. It is a matter of fact that the client will not have the regulatory protections available to an authorised body in relation to services provided by the separate business.

What seems important, and far from insurmountable, is that this fact, and also what elements of work are being respectively provided by the recognised body and the separate business, are made clear to the client.

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

In relation to Outcome 12.1 it may be sensible to revise the Glossary definition of 'actively participate' to make it clear that that does not extend to (prohibited) practising in the separate business and that the only active participation permitted in the separate business and with provision of services is non-practising participation. However, we do not consider this approach is the correct one.

In relation to the proposed referral outcomes (12.3 to 12.5 inclusive), we consider that it is unlikely that they will have the intended effect. They can be simply be by-passed by an authorised person which establishes a separate business, ensuring that its client/matter inception function is located in the separate business and that all referrals go from the separate business to the authorised person. It is not clear from the Consultation how or on what grounds the SRA would seek to categorize such arrangements as 'artificial'[5].

We would submit that a preferred approach would be to permit 'either way' referrals subject to clear signposting, including specifically as to what redress the client will lack if the services are provided by the separate business.

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

In the first example, it is not clear why if a client goes to X & Co first 'it is unlikely to be in the client's best interests' for X & Co to refer her to Accident Ltd for matter administration', given that it is acceptable for her to go to Accident Ltd first and be referred by them to X & Co for litigation. The client will retain regulatory protection for the service provided by X & Co. The critical issue appears to be that it is made clear to the recipient in both scenarios (and in further scenarios in your case studies) which business is doing what and what redress the client will have dependant thereon.

Scenario 2.2 is not particularly helpful as, if Estates Law's website represents that W & Y Solicitors will 'give you the peace of mind of full professional protection', that is a simple misrepresentation.

[5] See pp.114

In the case of City firms whose businesses comprise 75%+ of non-reserved activities, if all of that is hived down to separate businesses, the separate business may become the largest and brand bearing entity in the group. In terms of the SRA's 'BigLaw' example[6], reality could see (self-regulated) CityLaw becoming the principal brand driver and fielding all the corporate, M&A, wealth structuring, tax and employment etc services, via teams led by dynamic, trusted advisor 'lawyers' (who have incidentally come off the roll). CityLaw would reach out to its small, SRA authorised and regulated satellite, 'CityReserved', for conveyancing, probate and litigation inputs provided by a declining number of 'solicitors', potentially supervising paralegal teams. CityLaw would take on all clients and ensure that referrals only went from it to CityReserved.

The use of terminology in the BigLaw example is therefore odd. If BigLaw puts all its non-reserved legal advisory work into a separate business, that separate business is likely to be bigger than BigLaw. Why then would BigLaw call its new subsidiary BigLPO, particularly if the new separate business will contract direct with clients (as the example contemplates)?

There is no explanation in the example as to how BigLaw personnel will manage BigLPO or supervise work within it, without falling in breach of Rule 1 of the Practice Framework Rules. Unless work undertaken in BigLPO is directly supervised by solicitors, it would appear that legal professional privilege, in relation to it, will be lost.

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

We do not consider (see comments in our response to Question 1 above) that the significant number of waivers of the Separate Business Rule granted to ABSs shows there is a demand for different structures. On the contrary, the waivers were driven by the need for ABS investors to fit their existing business interests within the current legal services regulatory regime.

We would query for how long consumers[7] will 'continue to have the choice of instructing an LSA regulated business for their non-reserved activity', once the hive downs, which the Consultation itself contemplates, gather momentum.

We do not consider that your 'focus'[8] on the use of the title solicitor, will work to minimise the risk of client confusion. Few consumers (including sophisticated clients) will distinguish a solicitor from a lawyer (who may be a solicitor) and many will assume all legal advice is regulated.

In pp.13 you indicate that removing the Separate Business Rule 'will reduce the risk of authorised persons being at a competitive disadvantage to firms that are providing only unregulated legal services'. However, the latter are not subject to external regulation, associated governance restrictions or a turnover charge. As discussed above, for the experienced corporate solicitor, the option in the new world will be to hive off limited support services to the separate business or to make a wholesale leap out of the profession and into the unregulated sector as a lawyer. The SRA's proposals do not go far enough to remove the competitive disadvantages.

[6] Annex 3, p5

[7] Annex 4 pp.8

[8] Annex 4 pp.12

The header above pp.17 indicates that the Consultation's impact will include 'encouraging an independent, strong, diverse and effective legal profession'. The SRA appears blind to the fact that the actual impact may be a significantly shrunken legal profession and a significantly increased unregulated legal services sector, the latter not being subject to any diversity outcomes (beyond statutory obligations) or competency requirements.

Also in relation to pp.17, the SRA itself acknowledges that City firms will be at a competitive disadvantage to accountancy firms, who will find only their legal work subject to SRA regulation (including a tougher approach on conflicts) in ABSs in which they participate, whilst their own regulator will regulate their other work.

We would further comment that it will be interesting to see for how long the prospect of the non-availability of legal professional privilege provides (if it does) a brake on the hive down of non-reserved work to separate businesses. The SRA will be aware that some commentators have found the two dissenting judgments, in the case of R (Prudential plc & another) v Special Commissioner of Income Tax[9] to be persuasive and have speculated that legislation (to extend privilege) may follow. Will the SRA's proposals have an impact on any future government programmes for reform of the privilege rules? It would have been helpful to have seen a fuller discussion of privilege issues in the Consultation, including around whether advice privilege will apply to communications which are solicitor led (in a recognised body) but significantly supported by employees of a separate business.

An unintended consequence of the changes may be the NCA securing its desired upswing in Suspicious Activity Reports, if increasing volumes of legal advice are provided by practitioners, operating in the regulated sector (for POCA purposes), whose advice is not protected by privilege. On the other hand, the obligations of solicitors under POCA, including the anti-tipping off provision of POCA, may well present difficult issues for solicitor firms that have hived off to a separate business material portions of non-reserved activity in relation to financings, corporate transactions and other matters falling under the regulated sector under POCA.

Of course, many of the above issues are neatly avoided if (via change to the Practice Framework Rules) solicitors are permitted to practise and provide privileged advice in the unregulated sector, where they remain subject to a lesser form of personal regulation, which will, however, still give the regulator jurisdiction to act in the event of any serious misconduct type breaches.

We would have welcomed more comment in the Consultation on the international impact of the proposal. The shape of City legal practices may start to look different from their US and other international counterparts. Implementation of these changes could impact the selection of London as the headquarters location of international practices (including those originally founded in the UK). Alternatively, the international (client) market may rapidly accept the UK's big legal brands operating self-regulated, legal advisory businesses under their established brands as lawyers (not solicitors). However, the view of overseas regulators, and of overseas lawyers contemplating involvement with such businesses, may be less benign. This factor has the potential to create an uneven playing field as between firms with overseas offices and RELs and RFLs in their structures, and those without.

[9] [2013] UKSCI

9 Do you agree that the recognised bodies and RSPs should be allowed to provide the additional services proposed?

There seems no compelling reason why they should not be allowed to provide the proposed additional services, although we would question why, for example, recognised bodies would want themselves to provide accountancy services, thus subject to SRA regulation and the turnover charge, as opposed to offering them via a separate business. We do not consider this measure will significantly impact the direction of travel (of legal advice to the unregulated sector).

10 Are there any other services that should be allowed, bearing in mind the restrictions in s9 (1A) AJA and the regulatory objectives?

We consider not, given our views on the likely take up of the services which it is currently proposed should be allowed.

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.

The logical extension of these proposals is for all non-reserved activities, including legal advice, to be exempted from SRA regulation as only that change will create the level playing field with the unregulated sector. This would usefully prevent those firms with no other motive for restructuring having to set up separate businesses in order to provide their legal advice in the unregulated sector. However, the playing field would not be fully levelled until all unregulated work in the recognised body is exempt from the turnover charge. Pursuant to the current proposal, City firms can only work towards creating a level playing field by employing more paralegals and overseas qualified lawyers (subject to their local practising restrictions) in self-regulated separate businesses and by encouraging some or all of their solicitors to come off the roll and work in them.

In summary, we would urge the SRA to allocate more time to reviewing the premises on which its proposals are based and their likely impact and to conduct some bespoke and systematic research, including on revising the Practice Framework Rules, before acting hastily to implement change, which may ultimately work to cause irreparable damage to the ‘solicitor’ brand, including to its impact overseas, and drive significant numbers of the profession into the unregulated sector.

If the SRA is bent on implementing change now, solicitors should be allowed fully to participate and practise in the unregulated sector, whilst retaining the solicitor brand, which may act as a 'professional' differentiator from unregulated competitors, whilst providing significant consumer protections and acting to drive up standards in that sector.

Yours faithfully

City of London Law Society Professional Rules & Regulation Committee

Individuals and firms represented on this Committee are as follows:

Sarah de Gay (Slaughter and May) (Chairman)

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Roger Butterworth (Bird & Bird LLP)

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