SOLICITORS REGULATION AUTHORITY

Regulatory Reform Programme

Improving Regulation: proportionate and targeted measures

April 2015

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Simplifying compliance officer approval for small firms (1-4 managers)

CQ1 Do you agree with the SRA's proposal to introduce deemed approval for the COLP/COFA roles for sole practitioners and 1-4 manager firms?

The Birmingham Law Society ('the Society') does not accept that there is any justification for the removal of the requirement for lawyers to be approved as COLP/COFA to small firms. The assumption must be that the SRA can check the regulatory history of all lawyers. Its real concern must be, are the prospective COLPs/COFAs up to the job? This means that they must be *"of sufficient seniority and in a position of sufficient responsibility to undertake the role".* The SRA could deal with this by asking a question in the firm application form (the FA1) about why the firm thinks its prospective COLP and COFA are suitable for the role and ask them to outline their candidates' compliance/management experience.

The reality is that larger firms nearly always have candidates who are far better qualified than smaller firms to carry out these roles. Currently, sole practitioners often have to agree to undergo COLP/COFA training before the SRA will approve applications for new firms. It really comes down to the extent to which they can combine training with learning on the job - sometimes with compliance support from consultants. However, the SRA seems to be satisfied that if they have had the training they will be sufficiently skilled. The problem of being suitably skilled rarely applies with bigger firms.

At paragraph 10 of the SRA paper it is stated that, "*It is, however, considered to be a proportionate approach which avoids duplication of effort for firms and the SRA in situations where there is low risk, given the size of the firm"*. The SRA's belief that small firms equate to low risk is ridiculous bearing in mind that the majority of firms that appear before the Solicitors Disciplinary Tribunal are small firms. Further, it is very doubtful that such a view would be shared by the PI insurance market.

There should be one rule for all firms. It is not in the public interest in these particular circumstances for there to be a different rule dependent upon the size of the firm. The SRA needs to rethink the basis of this proposal. The suggested change to the FA1 would assist in meeting the SRA's regulatory obligations and at the same time making it possible to streamline the process in many if not most cases.

CQ2 Do you believe that deemed approval of COLPs/COFAs should be limited to certain types of firms? If so, which firms and why?

No – see response to CQ 1.

CQ3 Do you believe there are certain criteria or characteristics in a prospective COLP/COFA which should require us to assess their application nonetheless? If so, which criteria or characteristics, and why?

Please see response to CQ 1.

Simplify candidate declaration and notification processes

CQ4 Do you have any views on the SRA's proposal to simplify candidate declaration and notification processes

The Society accepts that there is an administrative advantage to the proposal in paragraph 17 but the SRA should bear in mind that if the candidate does not sign to verify that the information is correct it removes that candidate's personal responsibility for the accuracy of the information. If a deliberate misrepresentation is made to the SRA and discovered, the candidate can always blame the authorised person submitting the application for making a mistake and any subsequent inquiry becomes mired in claim and counter-claim. It provides a method of distancing candidates from personal culpability. To prevent this, a candidate must sign to verify the information supplied to the SRA.

The proposal in paragraph 18 to dispense with separate notification where the candidate is approved is sensible. However, candidates should be separately notified where the application is refused – there will be far fewer of these and therefore separate notification is more appropriate.

Remove the requirement for firms to carry out reserved legal activities

CQ5 Do you agree with our proposal to simplify authorisation by removing the requirement for firms to carry out reserved legal activities?

The proposal is *"to simplify authorisation by removing the requirement for firms to carry out reserved legal activities".* It is not clear what the SRA means by this. The headline proposal bears no relation to the detail contained in paragraphs 20 to 22 of the consultation paper. There may be some confusion.

The SRA needs to check carefully by reference to the Legal Services Act whether it can remove the requirement for firms to carry out reserved legal activities merely by amending its own Authorisation Rules. The SRA is an approved regulator in accordance with section 20 (5) of the Legal Services Act. It is granted the statutory power to regulate organisations that carry out reserved legal activities. In the case of an ABS wholly owned by non-lawyers there would be no point in applying to the SRA for authorisation as a licensed body if it was not intending to carry out reserved legal activities. It may as well continue unregulated say, for example, if it decided to offer employment advice.

The LSA makes it an offence for non-lawyers to provide reserved legal activities where not licensed to do so. However, we cannot see a specific provision in the LSA that requires ABSs to carry out reserved legal activities, although the assumption has always been that that is why they are applying to be licensed. In fact, a lot of applicants say they are going to conduct all the reserved activities in their ABS application but only have the intention of conducting one. They do not want to have to go back to the SRA to get approval to conduct others if they limit themselves in their application to 1 or 2.

The specific proposal contained in paragraph 20 is to remove the rule where the SRA can revoke or suspend a firm's authorisation where the SRA is satisfied that the body has no intention of carrying on the legal activities for which it has been authorised. The Society disagrees with the proposed amendment. The SRA should retain this power for exceptional circumstances – for example the SRA

might wish to consider revocation or suspension where a firm was conducting a wholly different activity from the delivery of legal services that might bring the profession into disrepute. It would not be restricted to a change of legal services.

Also, one might have the situation where a firm is regulated by the SRA but decides not to conduct any reserved legal activities. This could mean that the SRA might have no statutory power to regulate that firm. The SRA's statutory power emanates from the Legal Services Act and its jurisdiction over authorised persons – see section 18 of the Legal Services Act – this applies to both persons and licensed bodies. If the authorised persons are not delivering reserved legal work then the SRA may no longer have any jurisdiction over them.

The Society also disagrees with the other proposal in paragraph 22 whereby it is intended that there is no need to specify in an authorisation application the reserved legal activities for which the firm seeks authorisation. Surely the SRA needs this information in order to form a view as to the firm's suitability to be authorised? For example, if the SRA has no idea what activities the firm is planning to conduct how can it consider the firm's application? If say a firm wants to offer advocacy in the High Court to clients but has no qualified solicitors or barristers with rights of audience then this can be weeded out at an early stage by the SRA if it is informed of the firm's plans. Otherwise the SRA may have insufficient information upon which to base its decision in relation to authorisation.

Further consideration of the Legal Services Act and its relationship with the SRA's own Authorisation Rules appears to be needed here.

ABS Authorisation - operational changes and improvements

CQ6 Do you agree with our proposals to simplify the authorisation process for ABSs by:
a) removing the requirement for approval of managers in ABS corporate owners;
b) removing the 7 day notification requirement for authorised manager or owner of an ABS
c) revising the rules relating to reserved legal activity?

We agree that the proposal for removal of the requirement for approval of managers in ABS corporate owners has an administrative attraction.

However, would it satisfy the public interest test? Would the public be reassured that the SRA was subjecting these applicants to proper scrutiny if individual applications were not submitted? Could the SRA guarantee that it was able to weed out unsavoury applicants such as anyone intent upon money laundering or other fraudulent activities?

We suppose that if the SRA has concerns about the intentions of any particular individual who is applying to become a manager of a corporate owner it could ask specific questions about that individual's proposed involvement and if still unhappy, put conditions on the licence relating to that individual. However, the same concern applies as in our response at question CQ4 above: if there is no individual approval then this distances the personal responsibility for the accuracy of the information.

We agree the removal of the 7 day notification requirement – as per sub section (b).

We have answered the question under sub section (c) under CQ 5 above.

CQ7 Do you have any specific concerns regarding the SRA's proposals to simplify the authorisation process for ABSs? If so, please specify what these are.

The Society's concerns are that the SRA could by simplifying its procedures approve organisations as ABSs that ultimately damage the reputation of the legal services market. There are wider issues at stake here. Law firms are ideal targets for fraudsters as has been seen from the recent bank scams. Cybercrime, foreign terrorists, money laundering are other risks which are ever present. In trying to relax the rules for the approval of non-lawyer businesses, the SRA should not forget that it is a regulator not a chamber of commerce.

CQ8 Do you have any specific suggestions for the further simplification or streamlining of ABS authorisation?

No.

Changes to insolvency rules

CQ9 Do you agree with our proposal to adjust the regulations to cover the event of partnerships entering administration?

The proposal seems to be entirely sensible.

Alternatives to client accounts

At paragraph 35 of the paper it is stated that in reviewing the protection afforded to clients and their monies the SRA wishes to '*identify improvements to enable us to reduce costs, target protections, and ensure our regulatory restrictions and requirements are proportionate.'* The Society has conducted a non-scientific survey of its members and carried out inquiries with the Lyon Bar, with which it has a close association and which operates the CARPA system.

The protection of clients' monies is a paramount consideration. The overwhelming majority of firms hold a client account. For a few who never handle clients' monies the opportunity to operate an escrow account would provide no additional benefit or protection. From our inquiries even if the opportunity to have an escrow account were permitted none of the firms with whom we discussed the proposal (in excess of 20 including a representative selection of large national firms to sole practitioners) would elect to move to an escrow account.[1]

The first reason for this is the profession's long established reputation for safeguarding clients' monies and on the rare occasion when something goes wrong the client is reimbursed for any loss either

[1] Our attention was drawn to the fact that even now in some large international multi-million pound/dollar transactions, usually with an American flavour and often involving US banks, escrow accounts are sometimes used. Their use is limited to a specific transaction and the firms involved would under no circumstances wish to forsake their client accounts. Their use is clearly limited to quite specific circumstances unlikely to be encountered by all but a very few firms.

through the solicitors, their insurers or the Compensation Fund (as it stands)[2]. This is the USP of the profession and is valued highly by both the public and the profession: solicitors are trustworthy. Escrow accounts provide no greater protection: indeed in the event of a bank failure it could be argued that they represent a greater risk. Bailing out banks is probably unlikely to happen in the future. Their existence could also undermine the public perception of solicitors: 'they are not to be trusted with our money.' The Bar is in an entirely different position never having historically handled clients' monies, seldom involved directly in transactions and, of course, the Bar is differently structured (all who practise through chambers or from home etc. are sole traders).

It is suggested that the proposal would provide a means of achieving a reduction in cost. The experience of the CARPA system is the exact opposite. It is extremely bureaucratic employing in Lyon very many more people than we suspect do even the largest magic circle firms in London and largest firms here in Birmingham in their accounts departments. Lyon services some 2,000 or so avocats whose activities, it should be borne in mind, are largely confined to the work of the courts/tribunals and, specifically, not property work. In Birmingham and the Black Country, there are over double this number of practitioners and this does not include the wider West Midlands, only a relatively small number of whom are involved directly in court work. The majority will be dealing daily with transactions involving property, estates and a broad spectrum of commercial work.

However, it is not the cost to the practitioner and, ultimately, the client of setting-up or running the bank that has to be taken into consideration. Most firms have arrangements with their banks which in one way or another offset their banking costs for the obvious reason that the banks want to attract clients' monies whilst on deposit with the solicitor. The SRA will know that at any one time these amount to some very large sums. The savings on what would be the normal commercial charges by a bank (which are much higher than for personal banking) are considerable. In a highly competitive market the result is that the client benefits. For the same reason, borrowing to develop the firm can be much easier, which could be an important access to justice consideration.

The Society is far from convinced that any saving in the costs of compliance with the Solicitors' Accounts Rules would make such a difference to a firm's overheads to influence its decision on whether to move to a third party bank account. It is so marginal as to make no difference.

The final, and perhaps uppermost in the mind of a client, would be the inefficiency of the third party banking system. We are advised that in Lyon it will take several days for the CARPA system to get the monies to the client and his/her avocat. It is by no means unusual for a compensation payment to be delayed by a fortnight notwithstanding the bank being in funds. Perhaps the final insult is that no interest is paid out to the client to cover the delay unlike here.

Assume for the purpose of this exercise that all of this is due to Gallic bureaucracy and inefficiency and ignore the experience of practitioners gained over many years of trying to live with a system which many would readily exchange for ours. Say the Anglo-Saxon model would eliminate all of these problems (we suggest this is a flight of fancy but.....). This does not solve the problem of transactional log jams developing where a multiplicity of payments in and out have to take place on the same day, sometimes simultaneously. The best and most common example of this would be the completion of a chain of property sales and purchases. A chain of 3 or 4 is not uncommon and longer chains are not unusual. The solicitors are centre stage, able to monitor the progress of the transaction at first hand, not one place removed. Were a bank operating an escrow account at any point in the chain, the whole series of subsequent transactions would be held-up, possibly for days while the appropriate

[2] At paragraph 37 there is no evidence provided which suggests the misuse of clients' monies is significant when judged against the profession as a whole or that it is on the increase.

consents/authorities are being obtained, scrutinised and approved or not as the case may be. Meanwhile clients are left at best frustrated, at worst without a roof over their heads.

It is instructive to note that a CARPA system is not operated by the French Notaires.

For these reasons the Society does not see third party accounts as a panacea. We anticipate that even if they were available:-

- the take-up rate would be very small;
- in terms of protection for clients, the result would be neutral or possibly riskier;
- would be inefficient;
- would not reduce cost to the client but add to the cost of doing business.

CQ11 If so,
▯ should these be assessed and considered by the SRA on a case by case basis, or
▯ should the SRA identify a minimum set of safeguards that should apply to all third party managed accounts?

See our response in CQ10. Were the system to proceed it would have to be monitored closely by the SRA on a case by case basis. The risk of collusion, which may not be readily apparent, (e.g. a solicitor with a bank operated by a close trading partner such as an estate agency) or simply a fraudulent third party, [3]would be unacceptable and the SRA would not be discharging its obligations to the public were it to be otherwise. There is no place for outcome based regulation here.

It seems fair to speculate that there will be an increased burden placed on the SRA in regulating, authorising and thereafter monitoring third party managed accounts. The cost could be considerable, dependent on the take-up, which will ultimately fall on the profession. It is anticipated that significant costs would be incurred at the outset in recruiting staff with the requisite knowledge and experience of supervising banks and bank accounts. Further, we are not clear how the SRA would seek to exercise control over a third party over whom it has no jurisdiction. It is not inconceivable that a firm through no fault of its own could find its future in jeopardy because in the last resort the only weapon the SRA would have at its disposal would be action against the firm probably culminating in intervention.

CQ12 Are there any additional safeguards, not set out in Annex A, that you think we should consider in authorising the use of third party accounts?

See our response to CQ10. No comment, save to repeat that the Society sees no advantages to be gained over the current client account. If a bank fails and is not rescued or an insurer avoids a policy the client will almost certainly be left without compensation. A firm may fail but the profession remains intact and is always there to indemnify as a last resort (as the compensation fund presently stands).

[3] Fidelity insurance will not offer protection and be void if it is the principals who are dishonest.

Guidance on recording of non-material breaches

CQ13 Does the SRA's additional guidance on recording of non-material breaches provide further clarity on this requirement?

Isolated non-material breaches are clearly not in themselves a matter for concern. Nevertheless, if, as the paper recognises, there is a pattern of non-compliances where the same or similar issues arise repeatedly, the character of the non-compliance changes and becomes a material issue where the compliance officer is under a statutory obligation to report the breaches which would now be deemed material. The guidance on recording is not particularly helpful and the issue has become more confused that it needs to be.

The problem is self-evident: unless firms record non-material breaches, they will have no evidence of reoccurring non-material breaches. Similarly, unless the firm wakes up to the reoccurring problem and reports it, the SRA will as likely as not remain ignorant of what could be potentially significant breaches of the handbook. It is desirable that as much flexibility as possible should be retained and prescriptive 'guidance' avoided. Nevertheless, firms should be encouraged to keep a list of non-material breaches to be kept by the COLP and the COFA. It is a simple enough task. It also helps the COLP & COFA with risk management and general compliance so is a benefit more than a burden.

CQ14 Should the SRA also give consideration to removing the requirement for non-ABS firms to record such breaches? If so, why?

No. Unless the SRA abolishes the obligation to report material breaches it cannot abolish the recording of non-material breaches as they are inextricably linked to the recording and reporting of material breaches. With the present focus on self-reporting and the abolition by the SRA in 2011 of any regular visits to firms by the Practice Standards Unit, the recording of both non-material and material breaches is seen as a vital component of outcomes-focused regulation.

Clarification on the outsourcing of legal and operational functions

CQ15 Does the current rule in relation to outsourcing present unforeseen difficulties to firms wishing to take advantage of cloud computing options?

The Society is not aware of firms being prevented or handicapped in using new and emerging technology as a result of the rule. The current rule is adequate for the purposes of cloud computing. The proposed change is totally unnecessary and a waste of resources.

It is clear from Outcome 7.10 (b) that the option for the SRA to enter the premises is an alternative not a mandatory requirement. Where it would be impossible to enter premises as with a cloud computing supplier then the SRA would be entitled to inspect the records of the relevant supplier under the current procedures. A change to the rules is not needed.

CQ16 Does the addition of a guidance note on Outcome 7.10 provide sufficient clarity, or should the SRA make changes to this Outcome to provide further guidance to firms?
Recording and reporting of diversity data

Please refer to the response to CQ15 above

Recording and reporting of diversity data

CQ17 Do you have any comments on the SRA's proposal to clarify the current requirements for the recording and reporting of diversity data?

The Society is a little nonplussed by the SRA choosing to place another level of regulation here when, for the most part, the emphasis in the consultation paper has been in seeking means to reduce the burden of recording etc. particularly in relation to the proposal concerning the recording of non-material breaches (supra).

It is not suggested in the paper that firms are not meeting their obligation to have a written equality and diversity policy or that the ad hoc advice which the SRA is providing (which presumably is to ensure that the policy is being effectively implementation) is being ignored. At paragraph 63 it is recognised that firms are open to scrutiny as they are required to collect and report this data. The paper also acknowledges that the way in which the policy is applied will vary enormously with the size and character of the firm.

The justification for the proposal is that it will provide transparency and clarity. There is not a scintilla of evidence to suggest that there is a problem with firms not meeting their obligations and are being opaque or unclear about their policy. Nor is this asserted. The current flexibility leaving it to firms to decide how they collate data should be retained. The proposal is an unnecessary addition to the rule book, running contrary to the spirit of the SRA's strategy of reducing the regulatory burden.

Update on Apprenticeship Route to qualification

CQ18 Do you agree with our proposal to enable qualification as a solicitor through an apprenticeship route?

The Society is supportive of opening up new avenues to the profession and recognises the importance of diversity providing that there is consistency and equivalence of standards for entry into the profession by all routes. Therefore, we support the apprenticeship proposal and consequential changes to the Training Regulations providing the required benchmark and threshold for qualification as a solicitor is of a consistent and quality assured level. This is essential not only for the integrity of the profession but most importantly to ensure the protection of the public and credibility of the solicitor title.

How and when an apprentice is assessed is most important. An apprentice is committing his or herself to 6 years' work within the legal services via the Trailblazer route. If the assessment is all at the end for final assessments this is a huge commitment for both the individual and the firm. This is something

we are concerned about for individuals especially as there does not seem to be any stepping off stages. Therefore, we do see the benefit of apprenticeships within the profession if quality is maintained but we do think the assessments processes if all at the end need to be reconsidered. A route providing access to studying for an LLB part-time while working as an apprentice could be a good compromise, both enabling assessments to be done in stages and enabling the apprentice to achieve a qualification before the end of the 6 years.

If the apprentice qualification does not require a degree, then it is important to ensure that they are not considered at a different level by legal organisations again emphasising the need for apprentices achieving the criteria, standards and competencies required to enable them to have a transportable qualification within the profession.

Finally, guidance and support is necessary, particularly for smaller firms, as to the time, resource and supervision required if employing an apprentice to ensure that they receive a good experience as they may be unfamiliar with the workplace environment and professional etiquette and ethics required as some will be entering at 18 and will be in need of greater supervision than trainee solicitors.

BLS supports these diverse routes but only if rigorous quality mechanisms are put in place to monitor the standards to be achieved.

Fee sharing and referrals

CQ19 Do you consider that Outcome 9.6 should be retained or removed? Please give your reasons why.

The Society considers that Outcome 9.6 should be retained for the following reasons.

The SRA has as one of its principal objectives the protection of consumers' interests. The first issue must be whether Outcome 9.6 promotes or harms the interests of consumers of legal services of those accused of criminal offences.

In the overwhelming majority of cases, those accused of criminal offences are both distressed purchasers of legal services and extremely vulnerable, as the SRA paper acknowledges.

The overwhelming majority of those purchasing legal services in connection with criminal allegations are funded by the Legal Aid Authority ('LAA') as they cannot afford to pay for the legal services themselves. The service providers (i.e. solicitors) can only provide those services if they have contracts to do so with the LAA. That means that the solicitors' firms have satisfied the quality criteria of the LAA and continue to do so, on a rolling basis.

That being the case, it is difficult to consider any circumstances where a client would benefit by being sold by one firm of solicitors to another firm, both firms having legal aid franchise contracts and both firms satisfying the LAA quality criteria.

Because the overwhelming majority of these purchasers of legal services in respect of criminal allegations instruct firms of solicitors under legal aid funding, the issue becomes of whether clients' access to justice will be improved or enhanced by allowing referral fees. In England and Wales there

is currently an over-supply of firms with criminal legal aid contracts. If the Government's current proposals for limiting the number of suppliers are completed, the number of firms available is likely to be balanced to meet demand in any locality, according to the Government's own research. There is no reason to believe that access to justice will be increased or bettered by referral fees.

In the overwhelming majority of cases, those accused of criminal offences are not knowledgeable about the abilities of those offering legal services. Therefore, if a firm of legal aid solicitors wanted to refer a client to another firm, in most cases the client will not have the knowledge to know whether such a referral was in their best interests.

As the SRA paper notes, there are stories of clients being bought and sold, but there is no clear evidence to suggest that these stories are anything other than apocryphal. Even if there is some truth in them, there is no evidence that this trade is for the benefit of clients, as opposed to the firms involved. It is a *non sequitur*.

There is no doubt that there is a tiny proportion of consumers facing criminal allegations who do not fall into the above criteria. They are knowledgeable or have the abilities to make enquiries as to who might best serve their interests. They may already be clients of solicitors' firms in respect of the provision of non–criminal advice. Whilst there may be an argument for allowing referral fees in these circumstances, this group of criminal advice consumers represents such a small part of the body of those seeking advice in connection with criminal allegations that it is the interests of the overwhelming majority that must take precedence.

So far the only issue that has been addressed is Outcome 9.6 in relation to firms of solicitors referring clients between themselves. There is a separate issue of referral fees for the provision of advocacy services. This needs to be considered separately but our conclusion is that the above reasons equally apply here.

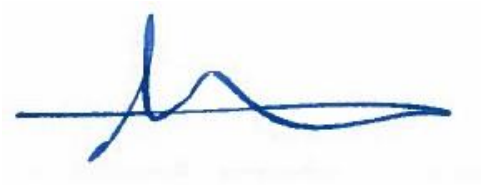
Paragraph 85 of the consultation paper suggests that firms will have different abilities in respect of the provision of police station advice, non–advocacy services post charge and advocacy services. Firms that are qualified to undertake criminal advice post charge are also qualified to provide police station advice by the provision of accredited solicitors or representatives. Pre and post charge advice go hand in hand.

There is a distinction between legal advice and assistance pre and post charge and advocacy services in respect of criminal allegations. LAA contract franchises provide for a continuous quality check in relation to all non–advocacy services, as well as advocacy in police stations and in the magistrates' courts. The SRA are in the process of introducing a continuing quality check in relation to Crown Court advocacy (QASA). Even without QASA, the rules governing solicitors with higher rights of audience and the rules of the conduct of the bar mean that Crown Court advocates must never take on cases that they are not capable of dealing with competently. There is no evidence that access to justice or the promotion of the interests of consumers of legal services in respect of criminal offences would be improved by allowing referral fees.

In the above, the question has been addressed solely on the basis of considering the best interests of consumers of legal services in respect of criminal offences and access to justice. However, there is the important ethical issue of whether it is acceptable to buy clients in criminal matters. There may be an

argument to say that an intelligent consumer of legal services can look after his/her own best interests after making their own enquiries and act accordingly by accepting or rejecting a recommendation. These form a small part of those needing advice and assistance in respect of criminal offences. The overwhelming majority are vulnerable and distressed members of society where the ethical imperative has to be that there should be no extraneous considerations entering into the relationship between the client and the lawyer for best advice. For such clients to be bought and sold, without any prospect of their being able to make an informed decision is as unconscionable as it is unethical.

Dated 9 June 2015



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