

**SRA BOARD**

3 June 2015

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**Changes to the separate business rule and to activities that can be performed by recognised bodies and recognised sole practitioners**

**Purpose**

1. This paper reports on the outcome of the consultation on the separate business rule and on permitted activities that can be carried on by recognised bodies and recognised sole practitioners.

**Recommendation**

2. The Board is asked:
  - (a) to note the report summarising the outcome of our consultation on the separate business rule and permitted activities for recognised bodies and recognised sole practitioners (at Annex 1), together with reports on the impact of our proposals on consumers (at Annex 2) and the market (Annex 3);
  - (b) to make the draft SRA Amendments to Regulatory Arrangements (Separate Business and Services) Rules [2015], which are proposed to come into effect on 1 November 2015 (subject to the approval of the Legal Services Board). (Annex 4); and
  - (c) to approve in principle the guidance to firms on the new Separate Business and Services provisions attached at Annex 5.

**If you have any questions about this paper please contact: Crispin Passmore, Executive Director, Regulation and Education, [crispin.passmore@sra.org.uk](mailto:crispin.passmore@sra.org.uk) or 0121 329 6687.**

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## **Changes to the separate business rule and to activities that can be performed by recognised bodies and recognised sole practitioners**

### **Introduction**

3. Our consultation on changes to the separate business rule (SBR) was issued on 20 November 2014 and closed on 12 February 2015.<sup>1</sup> In that consultation, we proposed to remove the existing prohibitions in Chapter 12 of the SRA Code of Conduct 2011 on regulated individuals and firms having links with separate businesses that carry on non-reserved legal activities. The consultation proposed instead to focus our regulatory requirements on outcomes which ensure that consumers are protected where these links exist.
4. The consultation also proposed extending the list in Rule 13.2 of the SRA Practice Framework Rules 2011 of services that recognised bodies and recognised sole practitioners can provide to the public directly through their practice (rather than through a separate body) to include certain professional and support services.

### **Responses to the consultation**

5. Our report detailing the responses to the consultation is attached at Annex 1. In summary, we received 19 responses, 6 of which were from representative bodies on behalf of their members, including the Law Society<sup>2</sup> and several local law societies. Responses were also received from the Institute of Chartered Accountants of England and Wales (ICAEW), the Legal Services Consumer Panel (LSCP)<sup>3</sup>, 10 individual regulated entities/legal professionals and one member of the public.<sup>4</sup>
6. Our analysis of the responses, and recommendations, were approved by the Standards Committee at its meeting on 8 April 2015, subject to some detailed comments which we have reflected in these papers.

### Separate business rule

#### *General prohibition*

7. The responses to the consultation were largely supportive of the proposals to remove the general prohibition on links with separate businesses, described by the Sole Practitioners Group as “arbitrary” and by the City of London Law Society (CLLS) (in the context of a market in which anyone can set up an unregulated legal services business) as “[beginning] to appear arcane”. However, many of the responses were

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<sup>1</sup> <http://www.sra.org.uk/sra/consultations/separate-business-rule.page>

<sup>2</sup> <http://www.lawsociety.org.uk/policy-campaigns/consultation-responses/separate-business-rule/>

<sup>3</sup> [http://www.legalservicesconsumerpanel.org.uk/publications/consultation\\_responses/documents/2015\\_0212\\_SBR.pdf](http://www.legalservicesconsumerpanel.org.uk/publications/consultation_responses/documents/2015_0212_SBR.pdf)

<sup>4</sup> Copies of all responses are available to Board Members on request.

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qualified, highlighting the need for strengthened consumer protection measures (discussed below at paragraphs 19 to 23) or for the reforms to go further in order to achieve a level playing field (at paragraphs 24 to 27).

8. Some respondents (eg. The Law Society and Junior Lawyers Division) were however opposed in principle to the proposals. Their key criticisms related to concerns: that the growth of the market of unregulated legal services would lead to detriment for consumers (particularly vulnerable consumers) due to our inability to ensure good standards of practice and service; that the market analysis<sup>5</sup> we carried out is insufficient and does not identify significant demand for the changes or that these would address areas in which there is unmet need for legal services; and that, as a matter of principle, solicitors should be subject to the same regulatory regime and requirements for all of the work that they do.
9. We have considered these concerns carefully. However, we agree with the response from the LSCP, which highlighted the need to achieve a *balance*: between consumer detriment from removal of some non-reserved activity from SRA regulation on the one hand, and the potential advantages of increased access to services at a potentially decreased cost to consumers on the other. We therefore, for the reasons set out below, consider that we should proceed with the proposal to remove the general prohibition.
10. The changes will allow solicitors/regulated firms to participate via ownership or management in what is already a large and growing market for legal and other professional services, which are not required to be subject to legal service regulation. It is worth noting that, in practice, the market has under the current regime developed in ways which combine alternative and solicitor services, under arrangements which are not caught by the SBR.
11. These areas of the market have consumer protections in place but, as described in our market analysis, this is currently patchy and poorly understood. We believe that it is appropriate to tailor our regulatory requirements so that these do not apply uniformly, in a one size fits all approach, to all areas of the market. We note the ICAEW's suggestion that "the SRA should be moving away from blanket and onerous regulation to a more flexible OFR approach" and the comment from the CLLS that it does not have appetite for an approach which mandates the SRA regulating all reserved and non-reserved activities carried out by solicitors, and their push for a "systematic and risk based review of solicitors activities".
12. However, we believe that allowing those regulated by the SRA, who will continue to be subject to our principles in all that they do, to participate as owners and managers will increase opportunities to enhance standards in this sector through normal management controls. These will include appropriate recruitment, training and supervision of staff; and through, as permitted now, the use by those businesses of 'in house' solicitors advising the business on standards and internal quality controls,

<sup>5</sup> See Annex 1 to the consultation at <http://www.sra.org.uk/sra/consultations/separate-business-rule.page#download>

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and non-practising solicitors. Further, we note the comment from CLLS that if and when City firms and solicitors start working in the unregulated sector, their brand and continuing client demands are likely to ensure a consistent quality of services across their regulated and unregulated components.

13. We accept that the analysis carried out in support of our consultation, and in our impact statements attached, is necessarily speculative at this stage. However, reform of the SBR will at least provide solicitors and other SRA regulated entities with opportunities to invest, to attract investment and to work with different business models. We believe this will help to increase access to legal services generally and will also provide opportunities to work more cost effectively – with the potential to drive down costs – and to offer holistic services – linking lawyers up with accountants and other professionals.
14. The argument for increasing competition and choice are supported by respondents such as the ICAEW and LSCP, and one legal services provider which commented that "By widening the options for firms to become regulated where there is a connection with a separate business, and by increasing the options for sustainability and growth for existing regulated firms this will increase the options for people to be recruited as solicitors. ... Improving competition whilst maintaining or improving standards has to benefit the consumer which is who this rule was supposed to be looking after."
15. The changes will also, in effect, simply formalise the current approach taken by the SRA in a significant number of cases, and implemented through waivers; and align with the approach of the other legal regulators which do not apply a separate business rule (including the ICAEW, as highlighted in its response). As we stated in our Policy Statement of May 2014, we have committed to an approach that the continuation of any existing regulatory intervention needs to be justified, rather than one of focusing on justifying its removal. Our analysis and the consultation responses have provided no evidence suggesting that the existing restrictions are justified. Further, we note the LSCP's comment that "every piece of unnecessary regulation imposes a cost that solicitors pass on to their clients and the accretion of these costs may make these services unaffordable".
16. Concerns were raised by some respondents (eg. the Sole Practitioners Group) that the changes would adversely affect competition and access to justice as it will be large firms carrying out certain types of work that will be in a position to take advantage of the changes, driving small firms on the high street out of business. It is not however necessarily the case that the largest firms (who tend to service large commercial clients) operate in areas of direct competition to smaller firms.
17. Comments were also raised in the consultation responses regarding the fact that the vast majority of waivers had been granted to new ABSs (60, as opposed to 2 granted to recognised bodies) and that this either indicated that these structures would be the ones to take advantage of a relaxation of the current rules and/or that this did not demonstrate demand for change as these waivers were a function of their external ownership and required in order to permit them to continue to provide what would

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otherwise be prohibited services. However, we do not believe that the existing pattern of waivers accurately reflects the potential appetite for change, noting that the current waiver criteria, which require the applicant to demonstrate exceptional circumstances such as significant and disproportionate cost in complying with the regulations<sup>6</sup>, tend to favour such applicants.

18. We consider that it is appropriate and proportionate, as a regulator, to operate a regime that allows all firms (large and small) to take advantage of the range of available business models, whilst recognising that, in practice, there are a number of factors which affect both large and small firms which are likely to limit the move of non-reserved work from regulated entities into a separate business. These factors include the structural and regulatory issues that would need to be considered, the fact that informed clients may not wish to do business with an unregulated provider and, in the case of international firms, restrictions in other jurisdictions on sharing profits with unregulated entities.

*Consumer protection*

19. Having said this, we are mindful of the concerns raised by respondents about the potential for consumer detriment, with all respondents highlighting as the key issue, the risk of consumer confusion regarding what is and is not subject to regulation. This is a particular risk where services or matters are split between separate entities.
20. The consultation proposed placing a ban on the referral of certain specific activities from an authorised individual/firm to a separate business. There was support from some respondents for the ban. However, we are persuaded by the arguments from a significant number of respondents that this proposal should not be pursued. These responses highlighted the difficulties framing and enforcing such a restriction, noting that it would be easy to avoid by making the separate business the first point of contact. Comments further highlighted that appropriate referrals between businesses can be cost effective and act in the interests of consumers, and that an outright referral ban would frustrate consumer choice.
21. We have therefore decided to adopt a more principles-based and outcome-focused approach to addressing the risk of consumer confusion. Namely, rather than introduce a ban on certain referrals, we propose to ensure that the authorised individual or firm obtains the client's informed consent in all circumstances where they propose to refer, divide (or allow to be divided) a client's matter with the separate business. We recognise the difficulty referred to by the LSCP and ICAEW in relying on and enforcing information remedies, and have drafted guidance (at Annex 3) to provide clarity around what is required. This highlights that informed consent should include the client being made aware of the respective regulatory position of the two firms, and the differences in safeguards (and the consequences of those differences), including legal professional privilege, and rights of redress (including access to the compensation fund and recourse to the Legal Ombudsman). They

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<sup>6</sup> See the SRA's guidance on separate business waivers <http://www.sra.org.uk/waivers/>

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should also be informed of the nature of the authorised person's connection with the separate business.

22. Of course, any referral to a separate business or division of a matter should also only occur if it is in the client's best interests in accordance with Principle 4 of the SRA Principles 2011, and the guidance also addresses how this might be approached in practice. We propose to seek views on the guidance from respondents to the consultation before this is finalised.
23. We recognise the importance of increasing consumer awareness more generally about the distinctions between the regulated and alternative legal sector and the regulatory safeguards available. Therefore, in addition to our on-going work in developing proposals for a regulatory register hosted by the SRA website, we propose to work with others, such as Legal Choices, to increase transparency in this area. We agree with the LSCPs recommendation that there should be consumer testing in this area and we will work with consumers via focus groups to test and develop information tools which will help consumers to make informed choices. We will disseminate these tools not only online but also via our existing network of contacts with groups representing vulnerable consumers that may not access information via the internet.

*Other consultation issues*

24. Our proposed amendments free up restrictions on solicitors owning, being owned by, managing or participating in separate businesses that carry out non-reserved legal activities. However, they do not remove current restrictions contained in the Practice Framework Rules that prevent solicitors from practising as solicitors providing legal services to the public in those separate businesses.
25. In its response to the consultation, the CLLS has argued that without removal of these practising restrictions, the proposals allow only limited involvement by solicitors (many of whom it says are likely to be the most qualified and experienced providers of non-reserved services in the market) in the alternative legal sector; and that this prevents them from exercising quality control over the work of those businesses.
26. We share the view that there is a need to review the current Practice Framework Rules in light of the changing market, and are proposing to consult on proposals to reform those rules later this year. Accordingly, whilst most respondents were in favour in principle of our proposal that the title 'non-practising solicitor' should not be used when providing legal services to the public in a separate business, we propose to postpone our decision on this aspect of the consultation as we consider that this issue is intrinsically linked to the question of solicitors' ability to practice in that capacity in unauthorised businesses.
27. However, we do not consider that the SBR changes should await that review. This is because, in our view, the ownership and management by solicitors and solicitor firms of businesses in the alternative legal services sector would allow them to have an impact on the quality of any legal output of the separate business (as highlighted

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above at paragraph 12). Further, as set out above, we believe there are good reasons to change the SBR irrespective of the outcome of the review of the Practice Framework Rules, and we do not believe that the current restrictions are justified. Failure to amend the SBR now would leave the SRA in the position of continuing to grant waivers to remove the current restrictions on a case by case basis. This is not a sustainable position, even in the medium term, as it places an unnecessary burden on applicants and the SRA in dealing with such applications, and provides a lack of transparency or certainty for individual firms.

### Operational impact

28. The Risk Centre has carried out modelling work to scope the potential impact on providers, looking in particular at the likelihood of a sample of firms moving non-reserved legal activities into separate businesses and the potential redistribution of regulatory fees as a result. The Impact Statement is attached at Annex 3.
29. The SRA recovers the actual cost of regulation each year, apportioned to individuals and firms (the latter on the basis of their previous year's "regulated" turnover). The nature of the data, for the reasons outlined in the paper, means that the analysis needs to be treated with caution and is intended to be illustrative only. As set out above at paragraph 18, there a number of factors that will restrict movement into separate businesses. Further, the analysis does not factor in possible counter trends such as an increase in regulated turnover if the change attracts an increase in investment in the regulated market and/or new entrants (such as potential ABS).
30. However, the analysis suggests that, whilst we believe that major short-term changes are unlikely, the main impact on fees could come from a relatively small number of large firms moving non-reserved activity out of SRA regulation, because of the high proportion of non-reserved services that they carry out. This would have the result of reducing the proportion of periodical fees recovered from those firms, with a resulting increase in the proportion recovered from other firms, if the funding formula remained unchanged. There could also be a similar impact on practising certificate fees if there was a consequential reduction in those working in authorised firms carrying out reserved legal activities.
31. As set out in the Impact Statement, we have modelled the ethnic profile of the firms we consider may be likely to take advantage of the proposals. These show proportionately slightly lower levels of BAME representation, with the largest differences in the BAME partners category. This would be consistent with the data in the SRA's diversity toolkit which shows lower BAME partner numbers in larger firms. Therefore we are mindful that any potential impact upon the fee levels of smaller firms will have a disproportionate impact on the regulated BAME community.
32. A reduction in the amount of turnover that is SRA regulated activity may of course be expected to lead to a reduction in the cost of regulation to the SRA and therefore the overall fees charged. Whilst we will clearly wish to take advantage of any opportunities to reduce the cost of regulation, there is not a simple relationship between regulated turnover and SRA costs – which tend to be driven by regulatory

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events and applications and renewals. However, we propose to review the appropriate balance between application fees, individual practising fees and turnover fees as part of the wider fees review later this year, in light of these proposals and of our review of the Practice Framework Rules.

33. In the meantime we will monitor the situation carefully, both in order that we are able to assess - and report back to the Board in November 2017 (as described in paragraph 35 below) whether the anticipated impacts materialise, and so that we are able to take action to prevent any disproportionate outcomes. As stated above, our analysis shows that the largest potential impact would come from those very large firms that have an ongoing relationship with a regulatory manager. This will enable us to obtain advance intelligence on any plans to change their business models in this way, and to take such potential developments into account in modelling fees for the subsequent year. Further, it has been our experience that changes in turnover lag some way behind market developments – most likely because existing cases take time to bill out. Thus, for example, the fall in overall turnover following the 2007 financial crisis took place over several years thereafter.

Monitoring and review

34. We also propose to amend the online PC renewal/annual return form to ensure that we receive targeted information on separate businesses that may present a risk because they carry on legal activities and/or clients will be referred to them. The Risk Centre will use this and other data that we hold on firms with separate businesses to monitor consumer impact in the medium/long term. By tracking those firms known to have taken advantage of the reforms on a regular basis, we will be able to identify any patterns in evidence of consumer detriment, for example reports or regulatory activity relating to misleading publicity, in firms with relevant separate businesses, as well as what other regulators are reporting, LeO complaints data and other information from qualitative sources such as research and media scanning, as well as structural changes in these firms.
35. We will publish a review of the impact of these changes on both providers and consumers by November 2017. This will also allow us to look at which firms have actually taken advantage of the rule changes and to consider any equality, competition and access issues arising.

Recognised Bodies and RSPs

*Permitted activities*

36. The consultation paper proposed expanding the services that recognised bodies and RSPs can carry out within their firms to include:
- professional and specialist support services to business, including: human resources; recruitment; systems support; outsourcing; transcription and translating; and

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- accounting services.

37. The consultation responses were overwhelmingly supportive of this proposal, with benefits highlighted including a more level playing field with ABS and the alternative legal sector, both of which are able to offer legal and non-legal professional services side by side within the same organisation, and the alternative legal sector. In addition, this was said to present a benefit to consumers (particularly small business consumers) by allowing them to access a wider range of professional services together. We therefore propose to amend Rule 13.2 of the Practice Framework Rules accordingly, to implement this change.

*Scope of SRA regulation*

38. There was a mixed response to the question as to whether all activity within recognised bodies and RSPs should continue to be SRA regulated activity, or whether there should be exceptions to that principle such as have been granted to multi-disciplinary partnerships. There were views from some respondents (the CLLS, and the Sole Practitioners Group) that this would go further towards allowing recognised bodies and RSPs to compete on a level playing field with ABS and the alternative legal sector. The ICAEW commented that if solicitors are providing services which are not associated with legal services, or could be expected by clients to be covered by SRA regulation, then such regulation is unnecessary; further, it is unlikely to be in the spirit of reducing cost and bureaucracy, or of increasing competition and liberalising the markets. However, other respondents (including the Law Society) raised concern at the idea that some of the work carried out in a firm of solicitors, marketed as being fully regulated, could be unregulated (and without oversight (as with MDPs) by other professional regulators). The Sole Practitioners Group commented that the alternative, of dual or even multiple regulation, raised difficulties and the potential for confusion amongst clients.

39. In the consultation document, we did not make any specific proposals, but sought to trigger debate on this issue. We consider that a case has been made to consider this further, and as a result, as set out in the consultation paper, we intend to return to this as part of a separate consultation.

**Recommendations**

40. **The Board is asked:**

- (a) to note the report summarising the outcome of our consultation on the separate business rule and permitted activities for recognised bodies and recognised sole practitioners (at Annex 1), together with reports on the impact of our proposals on consumers (at Annex 2) and the market (Annex 3);**

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**(b) to make the draft SRA Amendments to Regulatory Arrangements (Separate Business and Services) Rules [2015], which are proposed to come into effect on 1 November 2015 (subject to the approval of the Legal Services Board). (Annex 4); and**

**(c) to approve in principle the guidance to firms on the new Separate Business and Services provisions attached at Annex 5.**

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### Supporting information

#### Links to the Strategic Plan and / or Business Plan

41. This policy is linked to strategic objective three of our Strategic Plan: to develop the SRA regulatory arrangements and tools to better meet the regulatory objectives and the principles of better regulation and to mitigate emerging risks and anticipate changes in the external environment.

#### How the issues support the regulatory objectives and the principles of better regulation

42. We consider that the changes are consistent with the regulatory objectives to promote competition, a strong, diverse and effective legal profession, and access to justice; and the expected duty on regulators to promote growth.<sup>7</sup>
43. Further, the proposed changes will make our regulation more:
- Proportionate - by reducing unnecessary restrictions on business models
  - Consistent – by removing the need for individual waivers
  - Transparent – by making decisions in accordance with rules rather than individual waivers
  - Targeted - by focusing on preventing client detriment rather than restricting business models.

#### What engagement approach has been used to inform the work?

44. During the consultation period we discussed the issues with an external reference group members of which included The Law Society, CLLS, Birmingham Law Society, the Legal Services Board (LSB), the LSB Consumer Panel, the Legal Ombudsman and the Sole Practitioners Group. We also had separate meetings with individual stakeholders including purchasers of legal services and with 'Which?' to further discuss the consumer perspective.

#### What equality and diversity considerations relate to this issue

45. These are set out in Annexes 2 and 3 and at paragraph 31 above.

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<sup>7</sup> See <https://www.gov.uk/government/consultations/non-economic-regulators-duty-to-have-regard-to-growth>

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### Annexes

- Annex 1** Summary of responses
- Annex 2** Consumer impact statement
- Annex 3** Impact statement
- Annex 4** Draft SRA Amendments to Regulatory Arrangements (Separate Business and Services) Rules [2015],
- Annex 5** Draft guidance

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## **Summary of responses**

### **Introduction**

1. On 20 November 2014 we issued a consultation document seeking views on proposals to change the separate business rule (SBR) currently set out in Chapter 12 of the SRA Code of Conduct 2011. The proposals were designed to remove the prohibitions on links with separate businesses that carry out non-reserved activities and instead to focus the rule on outcomes that achieve consumer protection.
2. The consultation closed on 12 February 2015. This report summarises the key points emerging from the responses, and the SRA's position as a consequence.

### **The responses**

#### **Question 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?**

3. A number of respondents were in agreement with the conclusions drawn from the market analysis in the consultation, with one respondent noting that it demonstrated the complex consumer protection issues at play.
4. The Law Society felt that the market analysis did not offer enough evidence for the hypothesis that it is the cost of regulation that is inhibiting the development of new business models or the growth of cheap advice to SMEs or individuals. It noted that it would be essential to plan properly for the likely impact on the SRA's work and that of the regulated community.
5. The Law Society flagged a recent report completed on behalf of the Ottawa Trial Lawyers Association that had indicated ABSs have mainly concentrated in areas where work is easily commoditized and not necessarily where there is unmet legal need. It also noted the influence of very small businesses or individuals being the only complainants to the Legal Ombudsman (LeO) and the likely affect that would have on that data.
6. The Law Society also stated that work was needed to model the impact on suppliers of changing regulatory costs as some firms move work out of SRA regulation.
7. The City of London Law Society (CLLS) had a number of criticisms of the market analysis, including that it did not include reference to the report of Charles River Associates prepared for the LSB which stated that 'on the basis of educated

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guesses, most [City] firms estimated that the proportion of work that involved reserved activities would probably be less than one quarter'.<sup>8</sup>

8. One respondent felt that there was a clear need to review and consider the need for the SBR, noting 'the current SBR is, as the market analysis suggests, lagging behind market developments' in relation to how consumers access legal services.

**SRA response**

9. Although many respondents appeared to consider that the market analysis added value, a couple of respondents seemed to misunderstand its nature. The analysis was prepared specifically for this consultation. It seeks to review available evidence of the market changes relevant to the area of alternative legal service providers and to the potential effects of the changes. The analysis does not limit itself to data that supports the proposed changes, and does not argue for any particular solution. Instead our conclusions from the analysis were set out in the consultation document
10. Although there were some suggestions of further data that could have been included, we do not consider that the responses provided evidence to fundamentally change our main conclusions from the analysis. For example, we are aware of the Ottawa Trial Lawyers Association report and the impact of ABSs on the market is wider and more subtle than simply the areas where they predominate. We are also aware of the Charles River Associates report. The firms interviewed did not separately record reserved and non- reserved services but in fact their 'educated guesses' support our conclusion that corporate and business firms are less likely to base their work around reserved services than other firms<sup>9</sup>.
11. We agree that it is important to consider the potential differential impact of changes in regulated turnover on periodical and other fees charged to providers. We initiated this work during the consultation period, and our conclusions have been published as part of our final impact statement.

**Question 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?**

12. Respondents were divided on this issue. A number of respondents were supportive of the move to replace the ban on links with separate businesses that provide non-reserved legal services, with one respondent noting 'appropriate safeguards need to be put in place so that consumers are clear about the extent to which the services provided are regulated'.

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<sup>8</sup> <https://research.legalservicesboard.org.uk/wp-content/media/City-law-frims-and-regulation-2011.pdf>

<sup>9</sup> See e.g. paragraph 84 of the consultation document.

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13. One respondent felt that ‘there is real merit in the proposed rule change set out... [and] we agree with the conclusion that there is no need for general prohibition on separate businesses providing non-reserved legal activities and there needs to be a balance between any possible detriments to clients in relation to the removal of some non-reserved activity from SRA regulation, against the possible advantages in terms of increased access to services at a potentially decreased cost to consumers.’
14. Some of the respondents suggested that removing the ban and introducing an inflexible rule on referrals may not be in the interests of consumers and suggested that an outcomes-based approach would suffice.
15. The Law Society stated its overriding view that the SBR should not be relaxed, suggesting that the proposed rules could not protect clients of the separate business from any poor service delivered by that business. Their views were echoed by the Junior Lawyer’s division. Key criticisms related to concerns about the growth of the market of unregulated legal services leading to detriment for consumers (particularly vulnerable consumers) due to our inability to ensure good standards of practice and service; that the market analysis<sup>10</sup> we carried out is insufficient and does not identify significant demand for the changes or that these would address areas in which there is unmet need; and that as a matter of principle, solicitors should be subject to the same regulatory regime and requirements for all of the work that they do.
16. The Law Society also felt that the outcome needed to be much stronger to reinforce the separate nature of the two businesses, including preventing premises sharing or financial links between them.
17. The Legal Services Consumer Panel (LSCP) gave qualified support to the SRA’s proposals, conditional on the safeguards being strengthened and the information remedies being subject to rigorous consumer testing.
18. The current general prohibition on links with separate businesses was described by the Sole Practitioners Group as “arbitrary” and they stated that a levelling of the playing field between ABSs and traditional firms “sounds beneficial and fairer in theory”. However they had concerns that in practice the changes would adversely affect competition and access to justice as they felt it would be large firms carrying out certain types of work that would be in a position to take advantage of the changes, driving small firms on the high street out of business
19. The CLLS said that whilst it could see the logic of the SRA’s proposals and the SBR now ‘begins to appear arcane’, it should be amended at the same time as removing restrictions on solicitors practising in alternative legal services providers. It stated that: “The consultation proposal involves the SRA permitting authorised persons to hold limited and passive investments in unregulated legal service providers. The

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<sup>10</sup> See Annex 1 to the consultation at <http://www.sra.org.uk/sra/consultations/separate-business-rule.page#download>

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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. 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."

20. Failure to amend the practising requirements at the same time as amending the SBR would, the CLLS felt, put the solicitor brand at risk through separate businesses that were not quality controlled. It felt that a number of factors meant that, in the short term, City firms were unlikely to take advantage of the changes in the SBR. However, the CLLS contended that maintaining the restriction on solicitors practising in alternative legal services providers would lead in the longer term to the SRA being restricted to regulating reserved activities. If the reforms were to proceed, the CLLS asked for confirmation as to whether a solicitor supervising within an unregulated business would amount to 'practising'.

**SRA Response**

21. We consider that it is appropriate to proceed with our proposed reform, subject to the changes discussed below. We believe that the reasons for reform set out in our consultation paper remain compelling. The changes allow solicitors/regulated firms to participate via ownership or management in what is already a large and growing market for legal and other professional services, which are not required to be subject to legal service regulation. In practice, the market has under the current regime developed in ways which combine alternative and solicitor services. These include arrangements whereby unregulated legal services businesses provide the online entrance for consumers who can then access a range of offers from standardised legal documents right up to advice from a regulated solicitors firm.
22. In our policy Statement of May 2014, we committed to an approach that the continuation of any existing regulatory intervention needs to be justified, rather than one of focusing on justifying its removal. Our analysis and the consultation responses have provided no evidence suggesting that the existing restrictions are justified.
23. However, we accept that we need to provide clear guidance on the operation of the outcomes in order to protect consumers and we will ensure that this is in place. In our view, the issue of separation between the regulated entity and the separate business is best viewed from the consumer standpoint. It is important that it is clear to consumers that the businesses are separate and that consumers are aware at all times who they are dealing with. We think that going further and restricting financial links or forbidding sharing of premises would be an unnecessary restriction.

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24. We also recognise the importance of increasing consumer awareness more generally about the distinctions between the regulated and alternative legal sector and the regulatory safeguards available. Therefore, in addition to our on-going work in developing proposals for a regulatory register hosted by the SRA website, we propose to work with others, such as Legal Choices, to increase transparency in this area.
25. We agree with the LSCPs recommendation that there should be consumer testing in this area and we will work with consumers via focus groups to test and develop information tools to help consumers make informed choices. We intend to disseminate these tools not only online but via our existing network of contacts with groups representing vulnerable consumers who may not access information via the internet.
26. We have sympathy with the suggestion from the CLLS that there needs to be a review of the restrictions on solicitors practising outside of SRA regulated businesses. We are currently carrying out this review internally and intend to issue a consultation paper in autumn 2015.
27. However, we do not consider that the final decision on the SBR should await the results of that consultation. The changes allow the complete ownership and control of separate businesses by practising solicitors. They will be able to be personally involved in those businesses as managers or as in house solicitors providing quality control. We recognise that there are questions regarding the extent to which hands on supervision of a particular matter would comprise "practice" as a solicitor, and propose to return to this during our forthcoming review of the Practice Framework Rules. However, they will be in a position to recruit, train and - to a certain degree - supervise staff and their work, and to put in systems to improve quality, without this breaching current practising rules. They will have professional obligations (for example compliance with the SRA Principles) and will be bound by the outcomes of the SBR including ensuring that clients are not misled about the regulatory position.
28. If we delayed reform of the SBR pending the wider review of the Practice Framework Rules then we would continue to have waivers in place and would be very likely to have to issue new ones in the interim in order to be able to authorise ABSs. This would maintain a situation that is less transparent than a formal rule change and which it could be argued favours new entrants.
29. In that context, comments were made about the fact that most waivers had been granted to new ABSs, and that this was a function of their outside ownership. To obtain a waiver, it is necessary to demonstrate exceptional circumstances such as significant and disproportionate cost in complying with the regulations<sup>11</sup> It is not surprising that it is much easier for an ABS applicant which has an established business providing legal services outside of SRA regulation to demonstrate this than for an existing regulated body which is already providing all of its services within that

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<sup>11</sup> See the SRA's guidance on separate business waivers <http://www.sra.org.uk/waivers/>

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regulation. This is why the changes to the SBR in removing the need for waivers will help level the playing field between traditional firms and ABSs and provide the former with opportunities to take advantage of the increased flexibility.

30. Whilst we have noted the concerns of the Sole Practitioners Group and others and have considered small firms issues we consider that reform of the SBR will at least provide solicitors and other SRA regulated entities with opportunities to invest, to attract investment and to work with different business models. This will help to increase access to legal services generally. It will also provide more opportunities to work more cost effectively – with the potential to drive down costs – and to offer holistic services – linking lawyers up with accountants and other professionals. We have published an assessment of the proposals in relation to our regulatory objectives which considers these issues in more detail.

**Question 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?**

31. A majority of respondents felt that solicitors should not be able to describe themselves as non-practising when providing services to clients in a separate business, with many noting the likely confusion it could lead to for consumers.
32. Some of the respondents did highlight some of the practical difficulties that might arise from not allowing the description, including the problems in regulating what might be said to a consumer, as opposed to what is described in a business's literature.
33. One respondent did feel that that proposal was not necessary, noting that it could be adequately addressed by ensuring that 'clients were clear about the regulatory status of a non-practising solicitor... and by requiring solicitors only to be connected with a reputable and competent separate business with appropriate liability insurance.'
34. The CLLS also felt that solicitors should be in a position to describe themselves as 'lawyers' or 'former solicitors' where they have come off the Roll and are providing legal services to separate businesses, noting the familiarity with the brand of 'lawyers' due to its use by overseas qualified staff in many City firms.

**SRA Response**

35. Although we acknowledge the support for this proposal, we are also aware that the issue of the alternative titles that could be used by 'non-practising' solicitors has not been resolved. Further, this does seem to be one matter that should be dealt with within the wider review of the practising framework. We will therefore take no decision on this proposal at this time.

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

36. Most respondents did not agree with the proposal, with one respondent noting that it would undermine the role of the consumer in deciding what is in their best interests in respect of how they obtain their services. A number of respondents pointed out that defining the work that could not be referred would be difficult.
37. The Institute of Chartered Accountants in England and Wales (ICAEW) felt ‘the referral of matters ‘within a uniformly well regulated and well controlled group of firms is both cost effective and in very many cases in the interests of clients in other ways as well’.
38. The CLLS suggested that the referral ban could easily be avoided by making the unregulated provider the first point of contact. It stated that the issue of consumer confusion would be better managed by an outcome, guided towards the extent to which the client had been made aware of the parts of the service that were being provided by a separate business and the lack of access to recourse (for example via the Legal Ombudsman or the Compensation Fund).
39. The Law Society pointed out that ‘referrals between businesses are notoriously difficult to regulate and this is exacerbated where businesses are linked’. It stated that the bigger problem was the potential for inappropriate referrals from the separate business to the regulated firm: “The unregulated firm will be subject to no duties to ensure that the firm is in fact suitable for the client’s needs and there is a danger of a real absence of informed client choice here”.
40. The LSCP supported the proposed ban on referrals but stated that it should work in both directions. Some of the respondents also called for a dialogue with authorised bodies to discuss this issue and to reach a solution that would be proportionate to the needs of consumers, the SRA and the legal profession.

**SRA Response**

41. We are persuaded by arguments that an outright ban on certain types of referral would:
  - a. be likely to be ineffective as the regulated firm would arrange for initial customer contact to be with the separate business; and
  - b. lead to difficulties of interpretation; and
  - c. will not be appropriate if the referral is in the clients’ best interests and they have given informed consent.
42. Although the proposal by the LSCP to prohibit referrals both ways would deal with objection (a) above, we do not consider that a rule that prevents clients being

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referred from an unregulated firm to a regulated one is justifiable or in the interests of consumers, provided that the client is made aware of the connections between the businesses. Such an approach would also require us to revisit and amend waivers granted in relation to existing separate businesses without having any evidence of consumer harm in relation to those individual waivers.

43. We will therefore not proceed with our proposed ban on referrals. However Outcome 12.4 states that the authorised person may only refer a client to the separate business, or divide (or allow to be divided) a client's matter between them and a separate business when the client has given informed consent. Principle 4 of the SRA Principles 2011 will also mean that any such referral or division of a matter must be in the client's best interests.
44. The Outcome therefore now also covers situations where the separate business takes on the client and sends or refers the reserved aspect of the matter to the SRA regulated firm.
45. We will issue guidance on the Outcomes before implementation covering issues such as the client's best interests, clear separation of regulated and unregulated services, and 'informed consent'. In our view, the latter concept includes making clients aware of the specific differences in recourse between regulated and unregulated work and of the potential impact of such changes. For example, the client may lose recourse to the Legal Ombudsman or the Compensation Fund, or lose the benefit of legal professional privilege and compulsory professional indemnity insurance.

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

46. Many respondents felt that no bans on referrals would be necessary, taking the view that it is important to make clear to the consumer which elements of work were being provided respectively by the recognised body and the separate business.
47. One regulated entity suggested that guidance on referrals would be helpful for law firms, which should 'take into account the differences between consumers with limited legal knowledge and large businesses that have in-house legal teams'.
48. A number of respondents felt that an outcomes-based approach was preferable as long as there was adequate protection of clients and sufficient flexibility to enable the best outcome.

**SRA Response**

49. Whilst we agree that an outright ban on referrals is unnecessary, we have incorporated the concept of safeguards needing to be in place where an authorised person divides or allows to be divided a client's matter between them and a separate business.

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

50. Respondents provided a range of comments on the draft of Chapter 12.
51. The CLLS felt that draft Outcomes 12.3 to 12.5 inclusive would not have the intended effect, suggesting they might be by-passed by an authorised person establishing a separate business, ensuring that its client inception function is located in the separate business and that all referrals go from the separate business to the authorised person.
52. The Law Society highlighted a risk of the SRA and the profession funding the oversight of unregulated firms, depending on the type of conditions that are placed on the relationships between regulated and unregulated entities.
53. The ICAEW highlighted the proposed requirement mentioned in paragraph 116 of the consultation paper for authorised persons to notify the SRA of their connections to separate businesses, which it felt should be introduced as a rule in Chapter 12 as it offered an appropriate regulatory control. It also felt that Outcome (12.6) should be removed and replaced with a general rule to the effect that practising solicitors should not provide any legal services (reserved or non-reserved) unless these are provided under the regulatory remit of the SRA or any other approved legal services provider.

**SRA Response**

54. We have made the changes to the Outcomes set out above. It is not necessary to specify the requirement for firms to provide information relating to connections to separate businesses in Chapter 12 as this forms part of the general obligation on authorised persons to supply information to the SRA on request. There will be a specific question on connections to separate businesses in the annual return form.

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

55. The majority of respondents found the case studies appropriate; however a number felt that the likely outcome of SBR changes would be much more complex structures and cases than the examples given.
56. Some of the suggestions for further examples for inclusion were: fixed fee work for single pieces of drafting; free legal advice provided at drop-in sessions; and a case study on claims management.
57. One respondent felt that the case studies should clarify how solicitors will describe themselves when working within a separate unregulated business.

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#### SRA response

58. We will publish further case studies as part of the guidance in order to reflect the final version of the Outcomes.

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

59. The CLLS queried the focus on the use of the title 'solicitor', noting that 'few consumers (including sophisticated clients) would distinguish a solicitor from a lawyer (who may be a solicitor) and many will assume all legal advice is regulated.' It also asked if more information could be provided on the international aspect of the proposal and the possible effect that it could have on London as the location for the headquarters of international practices (including those originally founded in the UK).

60. One firm commented that it did not agree with the public interest justification for the SRA retaining a separate business rule. It argued that any potential detriment could be rectified by ensuring any referrals should only be made where these would be in the client's best interests.

61. The Law Society felt that a full equality & diversity impact assessment should be undertaken to consider the impact of the changes on both BAME clients and solicitors.

62. The LCSP stated that: "Our support is also conditional on the information remedies being subject to rigorous consumer testing. Such testing is critical as consumers have legitimate assumptions about the scope of regulation and solicitors have weak incentives to comply with information remedies. We would also like to see regulators pursue a common approach to help consumers understand the regulated status of services and the implications of this."

#### **SRA Response**

63. We have carried out modelling showing the potential differential impact of changes in regulatory fees as a result of work potentially moving out of regulation and this work is included in the final impact statement. These figures are illustrative only, as any modelling at this stage is inevitably speculative. In practice are a number of factors which are likely to limit the move of non-reserved work from regulated entities into a separate business, including the structural and regulatory issues that would need to be considered, the fact that informed clients may not wish to do business with an unregulated provider and, in the case of many international firms, restrictions in other jurisdictions on sharing profits with unregulated entities may limit their ability to take advantage of SBR changes.

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64. We have also published a consumer impact statement aimed at understanding the potential impacts and increasing the information available to consumers on the difference between regulated and alternative legal service providers.
65. We are committed to testing the effectiveness of our measures post implementation and adapting them as necessary. Firms will need to report details of separate businesses that will carry out legal activities or to which clients will be referred to us via the annual return form. We will use this information to monitor firms and compare with other information and events reported to the SRA (such as complaints and Ombudsman data) so that we can take action where necessary.

We will carry out a review of the market within 2 years of implementation looking at separate businesses in particular but including ABSs, MDPs and other forms of new business model. This will include looking at any equality and diversity impacts, any impact on fees and revisiting our consumer strategy and impact assessment. We consider that any significant movement is unlikely in the shorter term, but we will use our knowledge of the market (for example through regulatory management with larger firms) to react to more immediate changes should they occur.

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

66. There was widespread agreement with the proposal from respondents, with one suggesting that the proposed changes would go 'some way to creating an environment of increased fairness of competition between SRA and non-SRA regulated businesses'.
67. The Law Society, CLLS and ICAEW agreed with the proposals to allow recognised bodies and RSPs to provide the additional services proposed, although, due to a suggestion that recognised bodies might prefer to offer these services as a separate business, the CLLS felt the impact of this proposal on the overall direction of travel might be limited.
68. The LSCP felt the proposals would benefit consumers by providing wider choice and the delivery of 'one-stop shop' advice by extending the range of services that were provided by solicitors firms.
69. One of the respondents felt that the term 'accounting services' should be expanded to add in brackets 'save for audit services' to clarify that solicitors are not able to provide audit services.

**SRA Response**

70. We will implement the proposal as drafted. The SRA cannot authorise firms to provide audit services, but if a firm obtained such authorisation from a Recognised Supervisory Body then we would not wish to prevent this activity taking place.

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

71. There were few specific suggestions. The ICAEW suggested that any professional services should be permitted by the SRA where they are permitted under the terms of any relevant legislative provisions and provided that they are subject to appropriate regulatory provisions of the LSA or non-LSA regulation.

**SRA Response**

72. The restrictions imposed by the legislative framework make it difficult to provide very general exceptions, such as that proposed by ICAEW. We will implement the list of services as consulted upon, but we will be open to expanding this list in the future should a reasonable case be made to do so.

**Question 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.**

73. Respondents did not have a consensus view but many did feel that some activities should be exempted from SRA regulated activity. A minority of respondents, including the Law Society, felt that, where services were provided by a regulated body, all of that work should be regulated.
74. The CLLS suggested that the logical extension of the proposals would be for all non-reserved activities to be exempted from SRA regulation and this was the only change that might help balance the market with the unregulated sector.
75. The Sole Practitioners' Group felt that allowing non-reserved activity to be excluded from SRA regulated activity for multi-disciplinary practices has put them at a commercial advantage compared to solicitors firms.

**SRA Response**

76. We note the divergence of views on this matter. We will return to this issue in due course as part of our consideration of the issues in relation to the replacement of the current SRA Handbook.

**Other comments from the respondents**

77. The ICAEW felt the proposals could go further in meeting the regulatory objective around promoting competition, in particular in answering the LSB's assertion that the SBR is anti-competitive and that it should be removed.

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**Respondents to the consultation**

Type of respondent	Responses
Regulated entities / solicitors	9
Other legal professionals	1
Representative groups, trade, professional and membership associations	4
Local law societies	3
Members of the public	1
Other	1
TOTAL	19

Two regulated entities did not agree to their names appearing in a list of respondents.

**Regulated entities and solicitors in private practice**

Azrights  
Ian Tyes  
KPMG LLP  
Peninsula Business Services Limited  
Rees Page  
Riverview Law  
Name not provided (1)

**Other legal professionals**

Name not provided (1)

**Representative groups, trade and membership bodies, professional bodies**

Institute of Chartered Accountants in England and Wales  
Junior Lawyers Division of The Law Society  
The Law Society  
Solicitor Sole Practitioners Group

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**Local Law Societies**

City of London Law Society  
Leicestershire Law Society  
Liverpool Law Society

**Other**

Legal Services Consumer Panel

Member of the public (1)

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## **Separate Business Rule (SBR) changes – the consumer impact**

### **Introduction**

1. This paper considers the potential impacts on consumers of the changes to the separate business rule (SBR). It should be read in conjunction with the SRA's Market Analysis<sup>12</sup>. It is important to bear in mind some initial points.
2. Many consumers currently access alternative legal services (i.e. non Legal Services Act (LSA) regulated or unregulated legal services).<sup>13</sup>
3. Consumers are already purchasing services which will include a mixture of SRA regulated work and work that is unregulated or regulated elsewhere.<sup>14</sup> They may also receive unbundled services – where the solicitor only helps with specific parts of the case.<sup>15</sup>
4. Appendix 1 contains some examples of current market models which reinforce these points and demonstrate that:
  - The consumer experience may be very different from the formalities of SRA rules and legal structures.
  - In practice, the current market has ways of achieving the result of combining alternative and solicitor services – for example through contracts or less formal arrangements (which are not prohibited by the SBR) and the use of separate companies.
5. A number of consumer protections exist in the general law for alternative legal services.<sup>16</sup> The Consumer Rights Bill sets out a framework that consolidates in one place key consumer rights covering contracts for goods, services, digital content and the law relating to unfair terms in consumer contracts. The Bill also seeks to introduce easier routes for enforcement for consumers and small and medium enterprises ('SMEs').
6. Some alternative legal services providers are also covered by other regulatory bodies. For example chartered accountants will be members of one of six regulatory bodies

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<sup>12</sup> See <http://www.sra.org.uk/sra/consultations/separate-business-rule.page#download>

Annex 1

<sup>13</sup> SRA Market Analysis – section 1

<sup>14</sup> Ibid 1.9

<sup>15</sup> Ibid 6.6 -6.7

<sup>16</sup> Ibid 2.2-2.3

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and banks will be regulated by the Prudential Regulation Authority and the Financial Conduct Authority (FCA).<sup>17</sup>

7. Consumers make decisions through or using a range of behavioural tools that are well recognised in other fields, and we need to recognise this when thinking about how they choose their lawyer. Research suggests that consumers rely heavily on recommendations from people they trust when choosing a legal provider. Those that have used a provider before are likely to return to them for advice without comparing costs with other legal providers.<sup>18</sup> However, other data suggests that consumers frequently use the internet in seeking out legal services - for example Google's statistics from 2014 recorded 2million UK searches a day on legal subjects - implying consumers may be making efforts to build their knowledge and choice criteria.
8. Consumers don't really understand what regulation brings – but do think that professional titles including 'solicitor' means something about quality, experience and protection.<sup>19</sup>
9. This needs to be seen in the context of a complex regulatory background and the lack of market experience and inability to learn from repeat purchases for those consumers who may access services at times of crisis.
10. Courts and law are peripheral to everyday justice. Fewer than one in ten people experiencing legal problems instruct solicitors. Consumer experience does not mirror traditional legal services distinctions such as that between reserved and unreserved activities.<sup>20</sup>
11. Nevertheless, people are more likely to go to a regulated provider in relation to more serious problems, and problems taken to those providers are more likely to involve the courts.<sup>21</sup>
12. More than half of small firms handle legal problems alone rather than use lawyers;<sup>22</sup> whilst 54% of small businesses think legal services essential but only 13% think that solicitors offer a cost effective way to resolve issues<sup>23</sup>.
13. Sophisticated consumers may be better able to make distinctions and informed choices.

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<sup>17</sup> SRA Market Analysis 2.4

<sup>18</sup> Ibid 4.1

<sup>19</sup> Ibid 4.2

<sup>20</sup> <https://research.legalservicesboard.org.uk/wp-content/media/How-People-Resolve-Legal-Problems.pdf>

<sup>21</sup> Ibid

<sup>22</sup> <https://research.legalservicesboard.org.uk/wp-content/media/In-Need-of-Advice-report.pdf>

<sup>23</sup> Ibid

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### **Overview of the potential impact of changes to the SBR**

14. The waivers granted under the current SBR have been primarily, but not exclusively, to allow those that are already providing unreserved legal services outside of LSA regulation to continue to do so. The changes to the SBR will formalise that position without the need for waivers.
15. However, the changes to the SBR will also work the other way and allow solicitors to obtain a share of the alternative legal services market. This will include both taking work from current unregulated providers, and obtaining new clients.
16. These changes will also lead to clients that would have had their services delivered by a solicitor's firm now having those services delivered by an 'unregulated' entity linked to that firm instead. It is not possible to model with any accuracy how much this will happen. Various scenarios are discussed in the provider impact section. However, it may be that it will be large commercial law firms that are more likely to move work into separate businesses.
17. In any event, there are a number of factors that will tend to limit the amount of work that firms will transfer into a separate business in addition to any restrictions that the SRA maintains in place. These will include:
  - The desire not to lose the marketing value of a regulated brand. The separate business will have to compete with 'unauthorised' businesses without the 'social capital' that comes with professional title and regulation.
  - Informed clients may wish to remain with a regulated provider –for example for reasons of legal privilege.
  - The financial benefits to firms of moving cases out of SRA regulation may be limited. Although solicitors identify regulatory costs as a key issue for their business; SRA data suggests that the two highest costs are stated as compliance with money laundering and data protection legislation. Both of these requirements will continue to exist outside of SRA regulation.
  - Restrictions in other jurisdictions on sharing profits with unregulated entities may prevent large international firms from taking advantage of the changes.

### **What are the potential benefits for consumers?**

18. Ownership, management and quality control by solicitors of businesses in the alternative legal services sector may improve the standards of that sector's work.
19. Solicitors and other authorised persons will be subject to the SRA Principles and to key provisions in the SRA Code of Conduct governing their relationships with separate businesses. These latter will include the new Chapter 12, as well as Chapters 6 and 9 relating to referrals and introductions.

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20. Although individual solicitors will not be able to practise when providing services to the public in a separate business under current rules, solicitor owners and managers will be able to control the quality of output in several ways:

- Through normal management methods – including appropriate recruitment, training and supervision of staff.
- Through 'in house' solicitors (who may have practising certificates) providing internal advice and quality control.<sup>24</sup>

21. The changes may also widen access to legal services generally. As set out above, both individual consumers and small and medium enterprises can often struggle to access affordable legal services.<sup>25</sup>

22. Concern relating to legal costs has been further discussed by a report commissioned by the Legal Services Board (LSB):

“Recent years have seen increasing evidence come to light of cost acting as a barrier to the use of lawyers..... Where no legal aid is available, there is a simpler relationship, with access increasing along with income; except where conditional/contingent fees (or an equivalent form of alternative payment mechanism) are available, in which case there appears to be no relationship. Our new findings from the English and Welsh Civil and Social Justice Panel Survey (CSJPS) confirm that cost is a live issue among those looking to resolve legal problems. 57% of CSJPS respondents who obtained help from an advice agency rather than a lawyer indicated that they did so because of the perceived or actual cost of instructing a lawyer”.<sup>26</sup>

23. According to Citizens Advice data, 90% of its advice bureaux struggle to find specialist legal services to refer clients to.<sup>27</sup> Meanwhile, recent FCA statistics on consumer vulnerability shows that almost half of UK adults do not have the savings to cover an unexpected bill of £300.<sup>28</sup> Cuts to legal aid have made access to affordable legal services more difficult in some areas –the issue of family law is discussed below.

24. Reform of the SBR will provide solicitors and other SRA regulated entities with opportunities to invest, to attract investment, and to work with new business models. This will help to increase access, especially if it reduces costs of providing services.

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<sup>24</sup> We will be launching a consultation on the Practice Framework Rules later this year.

<sup>25</sup> See Market Analysis -6.1 and 6.2

<sup>26</sup> <https://research.legalservicesboard.org.uk/wp-content/media/How-People-Resolve-Legal-Problems.pdf>

'How people resolve 'legal' problems' Professor Pascoe Pleasance and Dr Nigel Balmer

<sup>27</sup> [https://www.citizensadvice.org.uk/Global/Migrated\\_Documents/corporate/aftf-infographic-web-optionb.pdf](https://www.citizensadvice.org.uk/Global/Migrated_Documents/corporate/aftf-infographic-web-optionb.pdf)

<sup>28</sup> <http://fca.org.uk/your-fca/documents/occasional-papers/occasional-paper-8-executive-summary>

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25. It will also provide more opportunities to offer holistic services – linking lawyers up with accountants and other professionals. These are particularly likely to benefit small business clients. Given the complexities of the market, it is not possible to model the precise impacts of these changes in advance.

**What is the potential detriment to consumers?**

- For there to be ‘detriment’<sup>29</sup> to an individual client as a result of the proposed changes to the SBR, **all** of the following conditions will need to apply:
  - i. The service must be provided by a separate business that is linked to an SRA authorised person<sup>30</sup>;
  - ii. If it had not been for these changes, the client’s service would have been provided by an LSA authorised person;<sup>31</sup>
  - iii. The client must have instructed the separate business without being informed, in a way that the client would be able to understand, about the difference between the regulatory protections and redress available to those that instruct an LSA authorised person and those that do not;<sup>32</sup> and
  - iv. Either:
    - a. the client receives a defective service<sup>33</sup> which causes them prejudice which is not remediable but would have been had the client instructed an LSA authorised person; or
    - b. the client loses legal professional privilege in a way that causes them prejudice, when such privilege would have been available to them had they instructed an LSA authorised person.

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<sup>29</sup> We only include detriment which will be a matter of regulatory concern – see note <https://www.gov.uk/government/publications/litigants-in-person-in-private-family-law-cases9> below.

<sup>30</sup> The term ‘authorised person’ includes an either an entity or an individual

<sup>31</sup> By way of illustration – a client may own a ‘buy to let’ house. The client routinely obtains the draft lease for each new tenant from an unregulated online provider. Following implementation of the changes, the client obtains their draft lease from a separate business connected to a local solicitor. In these circumstances the client has merely moved from one ‘unregulated’ provider to another.

<sup>32</sup> An informed client may choose an alternative legal services provider for reasons of price, convenience etc. Although that choice may later turn out to be the wrong one and cause detriment, this would not necessarily be of direct concern to a regulator given that the alternative legal services provider is carrying out a lawful activity which the LSA does not require to be regulated. However consistently poor service by a separate business might be an indication of a breach of the separate business rule or of one of the SRA principles by the linked SRA authorised person

<sup>33</sup> ‘Defective service’ in this context includes negligence, dishonesty, breach of confidentiality etc.

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26. One scenario is that a client may not have previously been able to access the legal service that they require from an LSA authorised entity at all (because of price, location etc.) but can now access this service from a more affordable separate business. In this case, the client has gone from no legal service to an 'unregulated' one. The research quoted above on the lack of direct correlation between legal need and current regulated supply would tend to support the conclusion that this will occur to some extent.
27. However, detriment could arise if so many SRA regulated providers move work into separate businesses that affordable (non-reserved) services in a particular category of law or geographical area are no longer available to consumers except from alternative legal services providers that offer less regulatory protection.
28. We do not consider that this is likely to happen, partly because of the reasons given in paragraph 17 above. We consider that other regulated businesses would be likely to move to fill the gap in the market given the advantages of branding that regulation offers and the opportunities for extending services to new areas provided by new technologies and business structures. For this reason, this assessment concentrates on the detriment potentially caused to clients by incomplete and incorrect information affecting their choice of provider. Whilst we agree that we need to monitor market changes in the medium and longer term, in fact better consumer understanding of the differences in protection between LSA authorised and alternative legal providers will help reinforce the advantages of the regulated brand and reduce the potential for any wider market detriment.

**Will impacts vary by different types of consumer?**

29. All consumers are entitled to clarity on their regulated position; no client should be misled. However, those falling within the category defined by Oxera as "legal persons (sophisticated)—larger companies, savvy charities, government"<sup>34</sup> may be expected to be more used to making informed choices when purchasing legal services and may require less detailed information. At the least, these clients will be more likely to know what information to request when purchasing from a new supplier.
30. It is also important to note that recourse will also be for different for these 'sophisticated' consumers who will not have a right of recourse to the Legal Ombudsman or to the SRA's Compensation Fund even if they instruct an SRA regulated provider. The financial issues at stake may also exceed the mandatory SRA Professional Indemnity Insurance requirements.
31. The modelling set out in the provider impact section suggests that it is often larger firms whose turnover includes more than 50% of non-reserved services and which therefore may be seen as more likely to set up a separate business. These will often be

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<sup>34</sup>[http://www.legalservicesboard.org.uk/news\\_publications/latest\\_news/pdf/a\\_framework\\_to\\_monitor\\_the\\_legal\\_services\\_sector.pdf](http://www.legalservicesboard.org.uk/news_publications/latest_news/pdf/a_framework_to_monitor_the_legal_services_sector.pdf)

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commercial law firms.<sup>35</sup> Issues of risk, quality and legal privilege will still be expected to be important for their clients and will form part of the decision process when purchasing legal services. However, sophisticated consumers will be much more capable than others of requesting and evaluating this information for themselves.

32. Our focus will therefore be on the more vulnerable clients and we will reflect this in guidance and the measures taken to improve the provision of information.

33. However, vulnerability is not static, as an individual consumer who might be empowered in most cases might be very vulnerable in distress purchases. In reviewing the options open to us we have considered whether we ought to introduce extra protections for those types of case where a client might be particularly vulnerable and where an 'after the event' consumer remedy would not suffice. We are also aware that BME clients are disproportionately represented in some of these categories.

34. The main categories of case that we have considered are set out below.

- **Criminal cases** - this work will mostly comprise reserved legal activity that could not be performed within a separate business. Those aspects that are not reserved (such as police station attendances) are likely to be covered in any event by the quality and other requirements contained in legal aid contracts.
- **Mental health law services** – these are mostly provided by special bodies that are not within SRA remit or via legal aid contracts which contain consumer protections.
- **Immigration asylum work** – this could only be performed in a separate business that was authorised and regulated by the Office of the Immigration Services Commissioner.
- **Public law children work** - this is mostly reserved work and, in any event, is performed under legal aid contracts with consumer protections.

35. In all of these categories of work, we therefore consider that the restrictions on the nature of supply mean that there is unlikely to be any significant impact on consumers resulting from the changes to the SBR.

36. We have also considered private law family children cases. Again, although much of this work will be reserved, it will be possible for this work to be performed in a separate business if it is pre-proceedings work or 'unbundled' so that the adviser is not conducting litigation or providing advocacy services. There may therefore be scope for separate businesses to provide services in this area.

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<sup>35</sup> See report by Charles River Associates prepared for 'LSB Benchmarking the supply of legal services by city law firms'. <https://research.legalservicesboard.org.uk/wp-content/media/City-law-firms-and-regulation-2011.pdf>. On the basis of "educated guesses", most city firms interviewed estimated that the proportion of work that involved reserved activities would probably be less than one quarter of their work.

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37. However, we do not consider it appropriate to maintain a specific restriction on links with separate businesses that provide private law children services. It is widely recognised that clients of limited means have significant problems in accessing legal services in this area following the implementation of the Legal Aid Sentencing and Punishment of Offenders Act 2012 and we do not consider that such a restriction would be proportionate.
38. A House of Commons briefing note in February 2015 states there was a 30% increase in family law cases where neither party had legal representation during 2014.<sup>36</sup> A Ministry of Justice study published in November 2014 into litigants in person in private law family cases found that the main reason for appearing without a lawyer was the inability to afford one. Appearing without a lawyer was wholly or partly a matter of choice for only a quarter of litigants in person.<sup>37</sup>
39. The Law Society has already provided guidance on how solicitors can unbundle their services in family cases so that they are not on the record.<sup>38</sup> The Legal Services Consumer Panel has pointed out that: "Policymakers have particularly seized on unbundling as part of an effective response to the increase in litigants in person following cuts in legal aid. Three quarters of all civil and family cases involve at least one litigant in person."<sup>39</sup> Unbundling can therefore lead to clients accessing a legal service where previously they would have not been able to.
40. In a report published in April 2014, the Legal Services Consumer Panel recognised the important part that unregulated fee charging McKenzie Friends can play in family proceedings:
- "McKenzie Friends can principally benefit consumers by improving access to justice and enabling greater equality of arms, especially when the other side is represented. For many litigants in person, the real choice is actually between using a McKenzie Friend or being entirely unsupported – lawyers are beyond their means and free support is not universally available. Family law clients, in particular, may not litigate out of choice, but are forced by circumstances to fight over hugely important matters, at a time of great emotional stress, in an environment that is unfamiliar and daunting to them."<sup>40</sup>

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<sup>36</sup> <http://www.parliament.uk/business/publications/research/briefing-papers/SN07113/litigants-in-person-the-rise-of-the-selfrepresented-litigant-in-civil-and-family-cases>

<sup>37</sup> <https://www.gov.uk/government/publications/litigants-in-person-in-private-family-law-cases>

<sup>38</sup> <http://www.lawsociety.org.uk/advice/practice-notes/unbundling-family-legal-services/>

<sup>39</sup> [http://www.legalservicesconsumerpanel.org.uk/ourwork/Litigants\\_In\\_Person/Unbundled\\_Researchs\\_pec\\_FINAL.pdf](http://www.legalservicesconsumerpanel.org.uk/ourwork/Litigants_In_Person/Unbundled_Researchs_pec_FINAL.pdf)

<sup>40</sup> [http://www.legalservicesconsumerpanel.org.uk/publications/research\\_and\\_reports/documents/2014%2004%2017%20MKF\\_Final.pdf](http://www.legalservicesconsumerpanel.org.uk/publications/research_and_reports/documents/2014%2004%2017%20MKF_Final.pdf)

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41. We therefore consider that the potential benefits of increasing access to legal services (linked to regulated services) are a factor in support of making the changes.
42. Whatever the category of law, individuals may be vulnerable due to other factors. These might include: disability; low literacy skills; or lack of access to the internet. These will all be factors to consider when information is provided to those consumers in relation to their regulatory position by providers or through general consumer information channels and specialist support networks.<sup>41</sup>

Minority client groups and equality and diversity issues

43. We consider that BME clients could benefit particularly from any increase in the provision of available services that result from these measures. According to a review of available research carried out by the LSB in 2011, overall BME individuals experienced civil justice problems more frequently than White individuals: 40.9% compared to 36.6%. The review also found that level of inaction in response was also higher, with 23% of BME individuals taking no action to solve a justiciable problem in comparison to 19% of White respondents (Pleasance et al, 2004). The incidence of employment problems different among ethnicities, with 10.4% of Black respondents found to have experienced problems in comparison to 5.2% of White respondents. The incidence of money or debt problems was more prevalent among Black respondents (9.5%) than White respondents (6.6%) (CSJS, 2007). This is supported by the finding that Black individuals are more likely to be in low income households than White individuals.<sup>42</sup>
44. SRA research on the experience of BME individuals using solicitors has found that:
- BME use of solicitors in the sample was less frequent than the general public (28% and 41% respectively) (SRA, 2009). The most commonly used legal service for BME people was conveyancing. The second was services related to personal injury.
  - Just 3% of BME people in the sample used solicitors for wills and probate services. This is low in comparison with the wider population where 14% of people use these services.
  - 34% of BME people used the internet as their primary method of searching for a solicitor.

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<sup>41</sup> See paragraph 49 below.

<sup>42</sup> <https://research.legalservicesboard.org.uk/wp-content/media/2011-Consumers-legal-needs-lit-review.pdf>

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- BME people in the sample were more likely than the general community to obtain information on their solicitor's background before using them. They were also more likely to ask their friends and family for information about particular solicitors.
- BME individuals in the sample were very positive towards the idea of buying legal services from a 'non-traditional' provider such as a supermarket chain. 43

45. This data does not therefore lead us to conclude that BME clients will be disproportionately affected by the changes. The research suggests that BME clients are already less likely to use solicitors for non-reserved services, and does not suggest that they are likely to be less able to use appropriate methods to seek out a suitable provider.

**How can the SRA minimise the potential detriment of the SBR changes?**

By including appropriate protections in the rules and guidance to ensure that clients are clear about the protections available to them and can make an informed choice.

46. Protections in the principles and the SRA Code of Conduct include:

- Requirements to ensure that clients are clear about their regulatory position.
- Obligations not to refer clients to separate businesses or divide matters with them unless it is in the client's best interests and the client has given informed consent. The concept of 'informed consent' includes the client understanding the differences in regulatory redress available and the potential consequences. In obtaining this consent, providers should take into account the vulnerability of individual clients so as to ensure that there is actual understanding and agreement.
- The principle of independence
- The duty of confidentiality

47. We will provide guidance including case studies to assist providers in applying these protections.

By effective supervision and enforcement of those rules where necessary

48. It is perhaps inherently less likely that clients will be misled as to their regulatory position by separate businesses owned and managed by solicitors with clear professional obligations than by current unregulated entities that have no such obligations.

49. Nevertheless, where rules are breached, the SRA will need to take effective action. As part of our strategy, we have improved the information that we request from firms in

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<sup>43</sup> <http://www.sra.org.uk/sra/how-we-work/consumer-research/summaries/experiences-of-black-and-ethnic-minority-people-using-solicitors.page>

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relation to separate business links in the annual return. We will be monitoring this information in conjunction with other data and intelligence that we receive on firms and the market. This will include looking at developing trends in complaints (including those made to the Legal Ombudsman) and of regulatory events and actions in relation to separate businesses.

By increasing the information available to potential consumers on the differences between regulated and unregulated providers and assisting them to make informed choices.

50. The primary responsibility to ensure that consumers are provided with the information to make an informed choice rests with providers.
51. We will also take steps to provide clear and publicly available information on the differences between LSA regulated services and the various types of alternative legal services. This information will cover other forms of statutory regulation outside of the LSA, and issues such as voluntary regulation and quality/kite marks.
52. We will make this information available on the SRA website. We will also work with the LSB and other regulators to include similar information on the Legal Choices website.
53. We are considering the most effective way to present this information, for example, through 'just in time' tools such as 'decision making trees' or other interactive tools which will assist consumers in their choice of provider.<sup>44</sup> We will test out alternatives with one or more consumer focus groups before implementation.
54. Not all consumers will have access to the internet or will choose to use it as a way of seeking information on legal services. We will use our relationships with consumer groups to help ensure that this information is disseminated to vulnerable and minority client groups via existing networks.
55. We will carry out an updated market analysis within two years of implementation to consider the impact of these reforms in practice, including on diverse groups of clients and diversity of supply. We will take into account the information we have obtained by our monitoring of regulatory events. We are also likely to carry out further qualitative work with consumers to help gauge the effectiveness of our controls.

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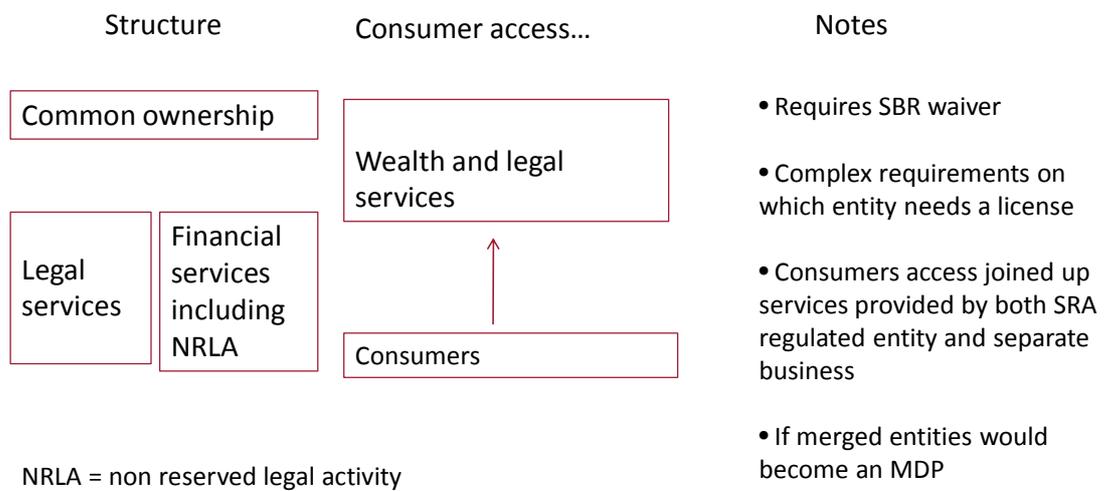
<sup>44</sup> See for example the John Maule research for the LSB  
<https://research.legalservicesboard.org.uk/reports/consumers-unmet-legal-needs/helping-legal-services-consumers-make-bet>

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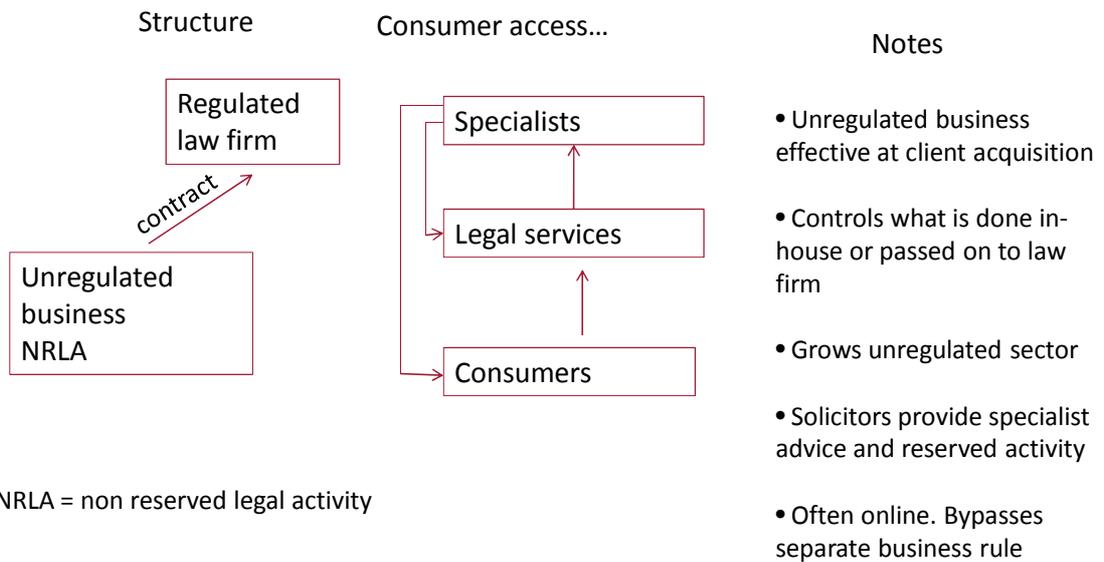
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## Changing market – ABS with SBR waiver



# Changing market – unregulated business as entry portal



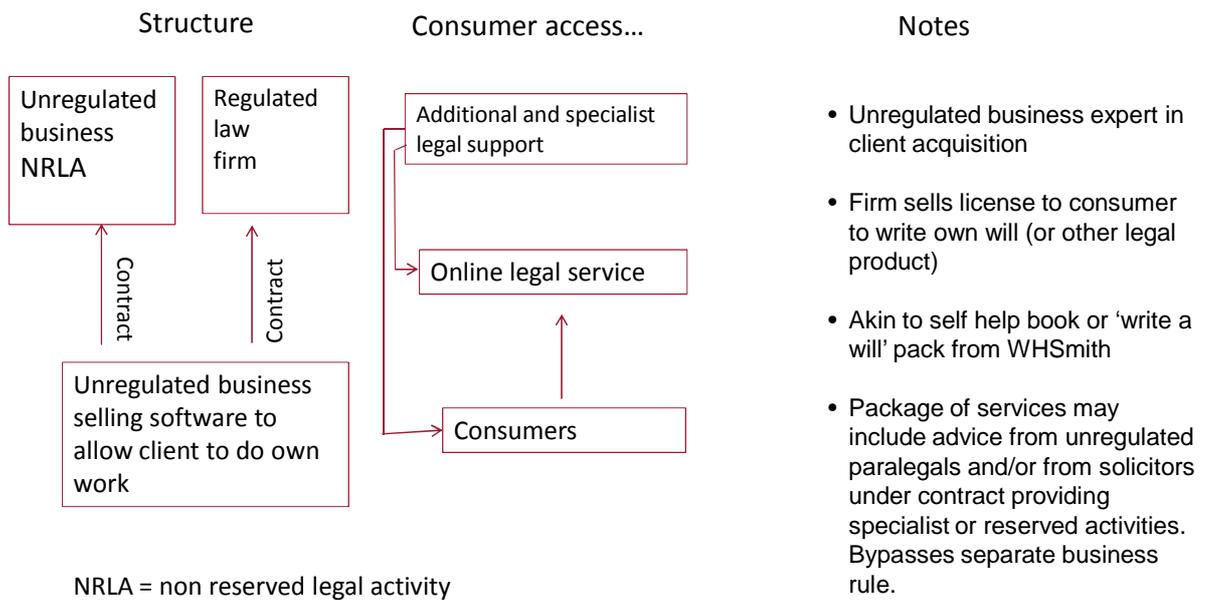
NRLA = non reserved legal activity

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## Changing market – packaged services

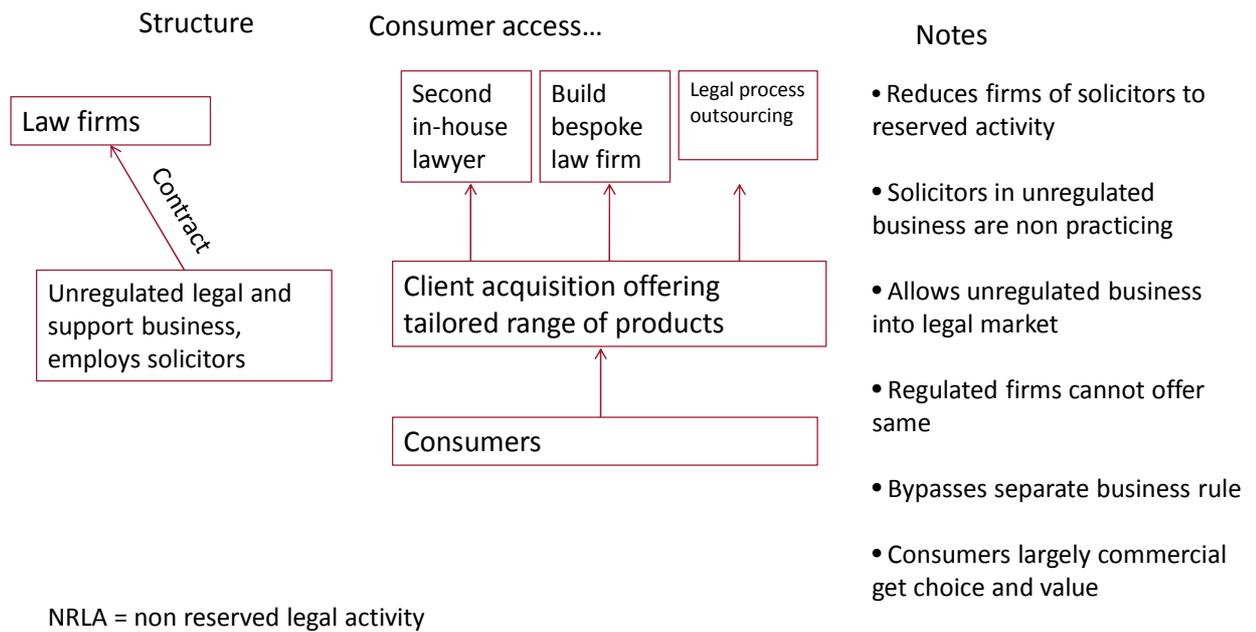


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## Changing market – services for commerce



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### **Separate business rule and recognised body changes - impact statement**

1. This impact statement comprises an assessment of the reforms to the separate business rule (SBR) and the extension of the activities that recognised bodies and recognised sole practitioners (RSP's) can carry out against our regulatory objectives, as also considered in light of our public sector equality duty and the better regulation principles. This statement should be read in conjunction with our market analysis which is referred to throughout.
2. Prior to the launch of our consultation the LSB carried out an assessment of restrictions on separate business against the regulatory objectives and better regulation principles<sup>45</sup>. We have noted that analysis, and have quoted from it below where relevant. However, we consider that protecting and promoting the consumer interest requires that we maintain a separate business rule that, whilst not prohibiting connections with separate businesses providing non-reserved legal activities, does contain provisions that will directly reduce the risk of consumer detriment.

### **Protecting and promoting public interest**

3. The LSA does not require non-reserved legal activities to be regulated, nor require restrictions on separate businesses. In those circumstances, if a client chooses to instruct an alternative legal services supplier then this is not in itself detrimental to the public interest. Indeed, the changes may promote the public interest by increasing competition and access to services. Problems will arise if reducing restrictions on associations with separate businesses increases public confusion about regulation, and increases detriment to clients as a result. This is in the context of evidence suggesting that private clients already do not understand the protections available to them and may assume all services are regulated.<sup>46</sup> This would suggest that safeguards are needed to help prevent such detriment. However in our view it is not proportionate to prevent authorised persons (that are used to operating to certain ethical and professional business) from owning or being connected with separate businesses delivering non-reserved legal services when anyone else can do so.

### **Supporting the constitutional principle of the rule of law**

4. We do not consider that these reforms will have a significant impact on this objective – either on the independence of the SRA or of the legal professionals that we regulate. We do not consider that allowing a wider range of business structures will compromise the principle of the rule of law. Conflicts between the business interests of an authorised

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<sup>45</sup> [http://www.legalservicesboard.org.uk/Projects/thematic\\_review/Business\\_Ownership\\_Restrictions.htm](http://www.legalservicesboard.org.uk/Projects/thematic_review/Business_Ownership_Restrictions.htm)

<sup>46</sup> Market analysis section 4

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person and the interests of a client can occur within a regulated business as within a group or connected business structure, and clients should be dealt with by authorised persons in accordance with the regulatory principles (including acting in the best interests of the client and upholding the rule of law).

**Improving access to justice**

5. By providing further business opportunities for regulated firms via separate businesses, and by making it easier for alternative legal services providers to form links with and/or become ABSs, we may increase the sustainability of regulated businesses and therefore access to justice. There is a significant level of unmet need for legal services for both private individuals and small businesses.<sup>47</sup> Allowing recognised bodies and RSPs to provide more services within their firm will also promote this objective.
6. The significant number of waivers of the separate business rule granted to ABSs shows there is a demand for different structures. However, the extent to which recognised bodies will wish to take advantage of a less restrictive rule is unclear.
7. If changes in the current rule lead clients to be confused about their regulatory position and then lead to subsequent detriment this could damage access to justice. However, the current rule may prevent SRA authorised firms from owning a share in established separate business or building up the profile of a separate business to attract clients who would never have instructed the regulated business.

**Protecting and promoting the consumer interest**

8. Our assessment of this issue is published separately.

**Promoting competition in the provision of services provided by authorised persons**

9. Removing restrictions on authorised persons from being connected with, investing in, or owning a range of businesses will reduce the risk of authorised persons being at a competitive disadvantage to firms that are providing only unregulated legal services. Allowing recognised bodies and RSPs to provide a wider range of services will also help to make those bodies more sustainable and increase competition.
10. The LSB's assessment of restrictions on separate businesses states "There is also a risk that regulations that restrict the ability of legal services providers from being connected with, investing in, or owning other businesses have the potential to drive legal services providers away from the provision of reserved legal activities in order to avoid regulation altogether. This would reduce competition in the market for reserved legal activities."

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<sup>47</sup> Market analysis section 6

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11. We would also add that such restrictions may in fact drive away legal service providers who are already regulated elsewhere (e.g. by the FCA, ICAEW etc.) from the provision of reserved legal activities in order to avoid duplicate regulation.
12. The SRA has granted a significant number of waivers to ABSs in order to try and avoid this latter risk. Maintaining the SBR would require continuation of this policy, which is a less consistent and transparent way of dealing with the issues.

**Encouraging an independent, strong, diverse and effective legal profession**

13. By providing further opportunities to diversify both internally (changes to recognised bodies and RSPs) and externally via a separate business, these changes are likely to contribute in making SRA regulated bodies more sustainable and better able to compete in the market place. It could be argued that the maintenance of the current restrictive approach may place current SRA regulated providers at a disadvantage not only against 'unregulated' providers but as against providers authorised by other LSA approved regulators that do not operate a similar rule.
14. We also consider that these changes will help meet the forthcoming duty to promote growth by increasing flexibility and investment opportunities.<sup>48</sup>
15. We have particularly considered whether there could be any negative impact on small firms, bearing in mind that BAME solicitors are disproportionately represented in small solicitor practices.<sup>49</sup>
16. Before consultation, we carried out an analysis of the incidence of performing reserved and immigration work based on the RF1 (annual renewal forms) from 2013-4 to see if small firms were more likely to perform reserved services. .
17. Our data shows<sup>50</sup>:
  - 96% of firms of all sizes carry out work in the reserved categories (or those likely to include reserved activities).
  - The incidence of doing conveyancing, probate and personal injury work rises with firm size.
  - The incidence of doing criminal work is lowest amongst sole practitioners and very large firms (81 plus partners) and highest amongst firms with 5-10 partners

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<sup>48</sup> - Department for Business Innovation and Skills (January 2014), *Draft guidance: non-economic regulators: duty to have regard to growth*,  
[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/274552/14-554-growth-duty-draft-guidance.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/274552/14-554-growth-duty-draft-guidance.pdf)

<sup>49</sup> 50.5% of BAME solicitors work in sole practices or firms with 2 to 4 partners compared to 28.7% of White European solicitors and 30% of BAME solicitors work in firms with 26 or more partners compared with 42.6% of White European solicitors.

<sup>50</sup> See Appendix A. Based on open head offices with current authorisation

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18. We then looked specifically at corporate and commercial work. This may be an area where firms will take advantage of the new provisions given the nature of the work.<sup>51</sup>
19. The Law Societies Market Assessment Report 2012-3 found that business and commercial services comprise 15% of turnover for small and medium firms. Firms undertaking corporate/commercial work in 2010/11 were, on average, significantly larger in size, whilst those generating 30% or more of their fee income from corporate/commercial work were larger still. However, sole practitioners were better represented than average amongst the sample firms generating 30% or more of their income from corporate/commercial work.<sup>52</sup>
20. There are two potential issues here that push in different directions. Firstly, if a firm is less likely to do the sort of unreserved work that will be split off into a separate business, then it will be less able to take advantage of changes in the rule. Conversely, the firm will face less competition from those that do so and is therefore less likely to suffer a direct impact.
21. It is therefore not possible to say that firms will suffer detriment because they are less likely to take advantage of the proposals. There is nothing that intrinsically prevents smaller firms from having links with separate businesses or trying new business models (there are a number of small ABSs for example). It may be generally true to say that larger firms may sometimes have more opportunities to react to market changes by virtue of their resources, but that is not a valid reason to maintain restrictions on business activities – rather it is a feature of the market as a whole. The regulatory objectives need to be balanced and maintaining otherwise unjustified restrictions on the basis that larger firms are perhaps more likely to use the new freedoms is not a proportionate response.
22. On the whole, therefore, whilst it is not possible to identify impacts in detail, we do not consider that the evidence suggests a negative impact in terms of market changes on small firms or on BAME or other minority groups.
23. However, one potential effect of the changes to the separate business rule relates to the differential proportion of regulatory fees paid by firms to the SRA. If some firms move turnover out of SRA regulated work, or employ solicitors in the separate business without practising certificates, then this would reduce the proportion of fees that they pay, and increase the proportion paid by the remaining firms *if* the fees formula remained unchanged and if the overall costs of regulation did not reduce.
24. We therefore carried out an analysis:

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<sup>51</sup> Market analysis section 3

<sup>52</sup> <http://www.lawsociety.org.uk/representation/research-trends/market-assessment-2012-13/>

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- To identify the possible factors that may lead a firm<sup>53</sup> to move all or part of its business outside of SRA regulation as a result of the Separate Business Rule (SBR) reform as proposed in the consultation.
  - To apply these factors to a sample data set of firms and consider future impact on their yearly reported turnover as a result of the proposed reforms.
25. It should be noted that integral to this work is an understanding of the type of work firms do and whether it is non-reserved or reserved. Firms would not be able to move reserved legal activities outside of the regulation of an Approved Regulator. We do not record the amount of reserved legal activities and non-reserved legal activities firms undertake. Firms do tell us the proportion of their turnover generated from 26 predefined work types. We have used the data relating to the work type as a proxy for the percentage of reserved legal activities and non-reserved legal activities they do.<sup>54</sup> However, these proxies are not an exact match and many will contain a mixture of both types of activity.<sup>55</sup>
26. We considered the reported turnover of 9,981 open firms at January 2015. These firms have reported a total turnover of approximately £21.3bn<sup>56</sup>.

**Findings**

27. The data cannot tell us how likely firms are to move non-reserved work out of SRA regulation. It does not take into account the effect of restrictions in the new Chapter 12 such as the requirement to obtain informed consent from the client. There are other market and regulatory factors which will restrict the actual movement of clients and of non-reserved work. Many firms may choose not to set up separate businesses. Further, any changes are likely to take place over several years, and this analysis assumes movement within one calendar year.
28. However, we have taken it as a reasonable assumption that firms that currently do a high proportion of non-reserved legal activities are more likely to move their non-reserved legal activities outside of SRA regulation.

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<sup>53</sup> For the purposes of this paper 'firm' means any authorised body (i.e. including both 'traditional' firms and ABSs).

<sup>54</sup> See Appendix B for the list of the work type categories and proxies.

<sup>55</sup> In this exercise we have taken a broad view of unreserved activity so as not to underestimate the effect. For example, in this particular analysis we have included debt recovery as 'unreserved', even though it will involve reserved activity if proceedings are issued. However this area lends itself to the use of separate businesses as bulk pre-litigation debt recovery activities could be split off into an FCA regulated vehicle.

<sup>56</sup> The turnover figure reported here is based on the information processed by us to January 2015 on the 2014/15 Renewal form. This is based on a large sample of firms so the turnover figure here is used for illustrative purposes and should not be reported as accurate of all firms. We are satisfied that a sample of 9981 is sufficient for the purpose of this paper. Firm turnover figures have been scheduled to be validated in April/May 2015. The figure may significantly change after the validation.

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29. Our analysis has shown that firms with one or more of the following attributes are more likely to do more than 50% non-reserved legal activities:

- £13m or more yearly turnover
- do not hold client money
- do not pay referral fees
- recently formed or changed their constitution type
- have 500 or more fee earners

30. A further analysis of non-reserved legal activity suggests that very small firms (turnover up to £200k per annum) are slightly more likely to do more than 50% non-reserved legal activities compared to the medium sized firms determined by turnover. Our finding suggests that these small firms are mainly dominated by the firms that do more than 50% immigration work, which would need to be authorised by the Office for the Immigration Services Commissioner if it was moved into a separate business.

**Impact on periodic fees and PC renewals**

31. We modelled a number of scenarios where various percentages of the non-reserved work are moved out of SRA regulation.

32. The modelling shows the potential reduction in periodical fees collected from the selected firms if the turnover formula remained unchanged. This is for illustrative purposes only. Although we use terms such as 'reductions' or 'gaps', in practice, any changes in SRA regulated turnover would not reduce overall SRA fee income, as the SRA charges the costs of regulation each year apportioned to firms and individuals; in the case of firms the apportionment is according to their previous year's turnover. However, changes such as those modelled would be likely to result in a reduction of periodical fees collected from the sample firms and an increase in periodical fees collected from the remainder of firms in the subsequent year if the funding formula remained unchanged.

33. We have also modelled a similar reduction of practising certificate (PC) fees collected from the selected firms. As explained above, this would be redistributed by increasing the PC fee level. We have modelled the reduction on the assumption that the number of practising solicitors in the regulated firm will reduce in line with the reduction in regulated turnover. It does not take into account whether individuals will maintain their PCs whilst working for the separate business "in-house" or whether PC holders are more likely to conduct reserved legal activities as opposed to being evenly spread across work types.

**All firms**

34. Out of the total £21bn turnover reported in the 2014/15 renewal form, about £9.7bn was reported to have been generated from the areas we have classified as non-reserved legal activities.

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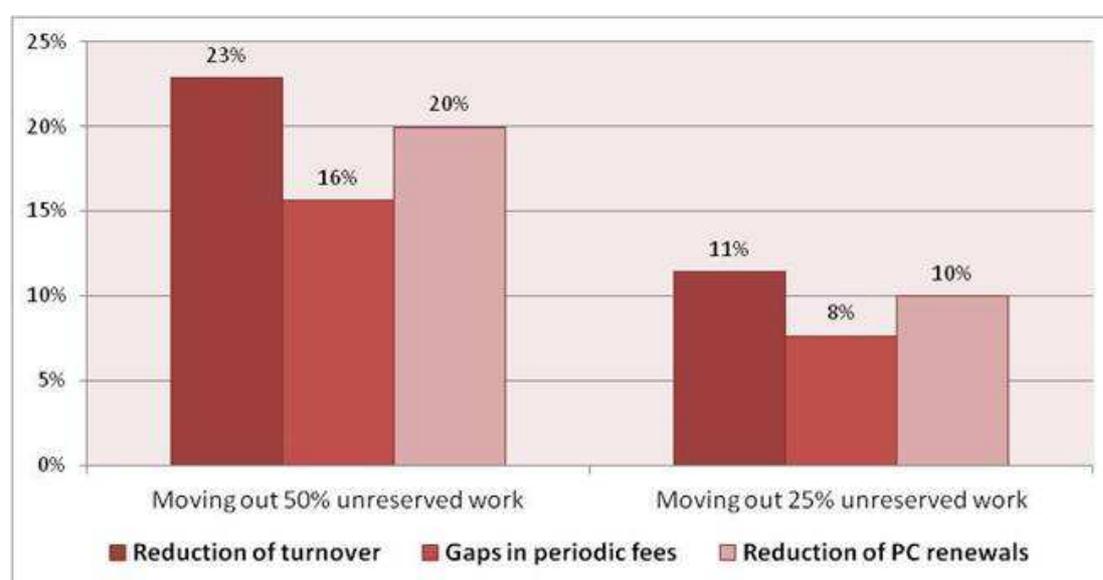


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35. We estimated the possible impact on the total periodic fee and PC renewal numbers if 50% or 25% of the non-reserved legal activities carried on by **all** of the 9,981 firms were moved outside of SRA regulation.

36. The chart below shows the results:

**Chart 1: Relative impact of a reduction in non-reserved legal activities on turnover, periodic fees and PC renewal (all firms)**



37. This chart shows that if 50% of the non-reserved legal activities carried out by all firms were moved outside of SRA regulation, the total turnover would reduce by 23%. This could result in a 16% reduction in the total periodic fee, when using the 2014/15 calculation, while total PC renewals could reduce by 20%

38. By contrast, if 25% of the non-reserved work carried out by all firms was moved outside SRA regulation, the drop in turnover could be 11%, the reduction in periodic fees 8%, and the reduction of PC renewals 10%.

**Firms that carry out 50% or more non-reserved work**

39. Of the 9,981 firms analysed, 2,689 firms have reported at least once in the last four years that more than 50% of their turnover was generated from non-reserved legal activities. These firms reported a total turnover of approximately £10.1bn in their 2014/15 renewal form. This accounts for 48% of the total turnover reported in the 2014/15 renewal form.

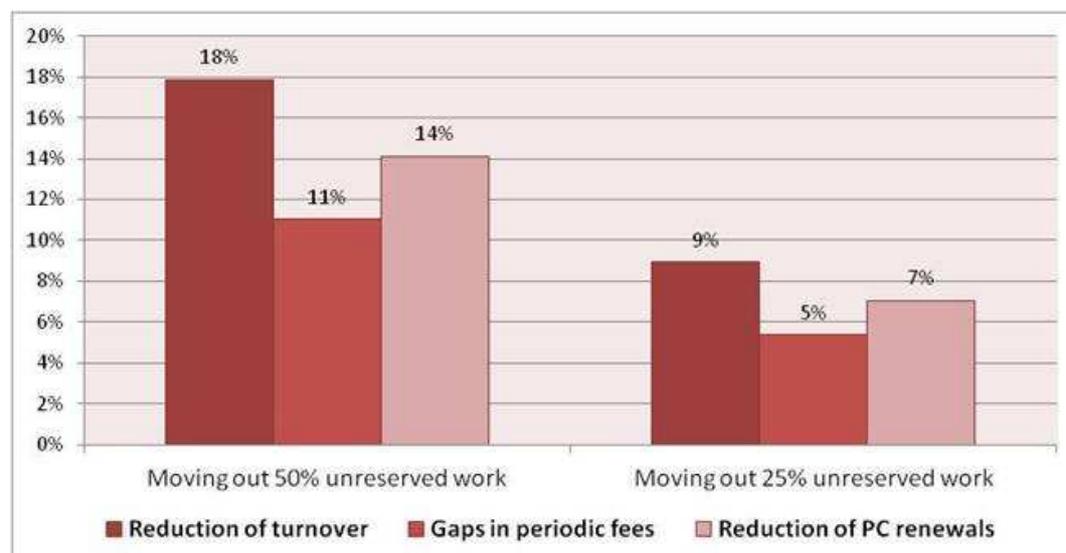
40. Chart 2 shows the impact of these 2,689 firms moving non-reserved legal activities on turnover, periodic fees, and PC renewal based of 50% and 25% movement.

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**Chart 2: Relative impact of a reduction in non-reserved legal activities on turnover, periodic fees and PC renewal (all firms that do 50% or more non-reserved legal activities)**



- 41. This chart shows that if 50% of non-reserved legal activities carried out by the 2,689 firms were moved outside of SRA regulation, the total turnover of all firms would reduce by 18%. This could result in an 11% reduction in the periodic fee, using the 2014/15 fee calculator, and PC renewals could reduce by 14%.
- 42. By contrast, if 25% of non-reserved legal activities carried out by the 2,689 firms were moved outside of SRA regulation, the drop in turnover could be 9%, the reduction in periodic fees 5% and the reduction in PC renewals 7%.

**Top 200 firms that carry out 50% or more non-reserved work**

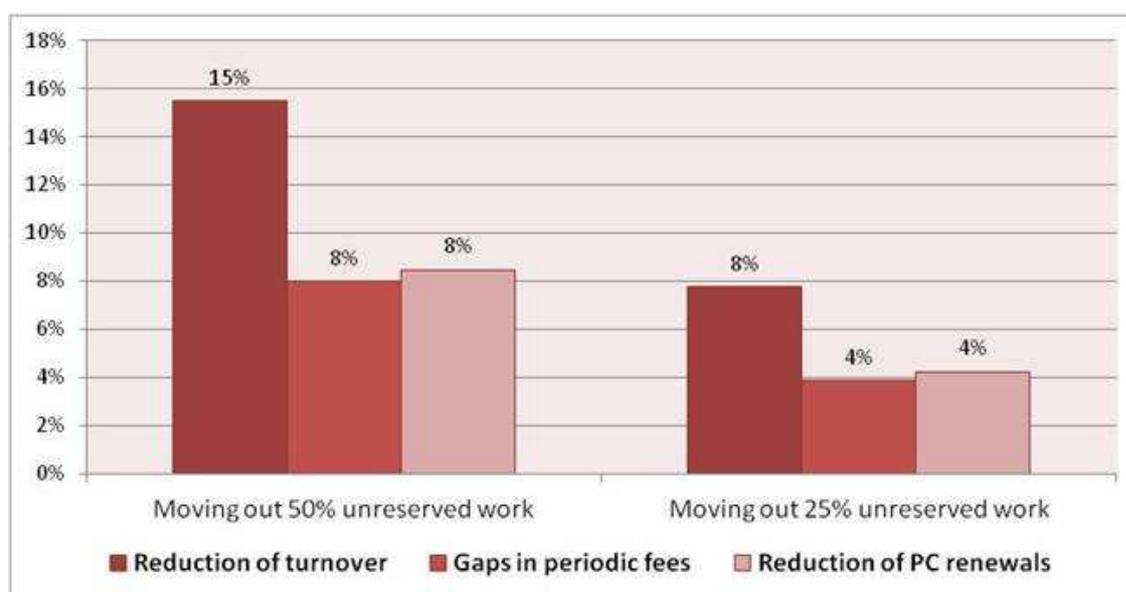
- 43. We also looked at the top 200 firms by turnover. 98 firms from these top 200 firms reported that more than 50% of their turnover was generated from non-reserved legal activities at least once in the past four years. These 98 firms account for £8.9bn in turnover, which is 42% of the total turnover of all of the firms analysed.
- 44. As with the other sections, we have estimated the impact on turnover, the periodic fee (using the 2014/15 calculation), and PC renewals. The results can be found in chart 3 below:

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**Chart 3: Impact of a reduction in non-reserved legal activities on turnover, periodic fees and PC renewal (Top 98 firms that have conducted more than 50% non-reserved legal activities at least once in last four years)**



45. This chart shows that if 50% of the non-reserved legal activities carried out by the 98 firms were moved outside of SRA regulation, the total turnover of all firms could reduce by 15%. This could result in an 8% reduction in the periodic fee, using the 2014/15 fee calculator, and total PC renewals could reduce by 8%.

46. By contrast, if 25% of the non-reserved legal activities carried out by the 98 firms were moved outside SRA regulation, the drop in turnover for all firms could be 8%, the reduction in periodic fees 4%, and the reduction in PC renewals 4%.

### **Splitting activities**

47. A further factor may be the type of reserved legal activities a firm conducts and whether this work relies on introducers who may retain part of the work or can be easily unbundled into component parts. We have looked at some of the key reserved legal activities that could meet this criterion - personal injury (PI), conveyancing, and probate. Where an aggregate of a firm's work is more than 70% from these work types, we have modelled the possibility that the firm may offer services through a separate business. For example, they may take ownership of an introducer such as a claims management company or may separate off estate administration and will writing from probate or 'administration' from conveyancing.

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48. Our analysis has shown that firms with one or more of the following attributes in the sample are more likely to do more than 70% PI, probate and conveyancing work:

- A medium size firm by turnover figure<sup>57</sup>
- hold client money
- pay £500k or more on referral fees
- have not changed constitution type for long time
- have 1 to 5 fee earners

49. Of the 9,981 firms analysed, 2,155 have reported that 70% or more of their yearly turnover was generated from one or more of these categories in their 2014/15 renewal form. These firms have reported approximately £2.7bn turnover in 2014/15 renewal form. We calculated the total periodic fee from these 2,155 firms to be £10.5m when using the 2014/15 fee calculator. This amounts to 16% of the total periodic fees paid by the firms analysed.

50. PC renewal fees from these firms amount to approximately 12% of the total.

51. This information is provided to give some indication of the overall market share of these firms but we believe this factor to be more difficult to measure than firms who already conduct large amounts of non-reserved work.

**Analysis of the ethnic profile of the sample firms**

52. We carried out an analysis of the ethnic profile of (a) the 2,689 firms have reported at least once in the last four years that more than 50% of their turnover was generated from non-reserved legal activities and (b) the 2155 firms that carry out more than 70% probate, conveyancing or personal injury work. We then compared this profile with the profile of all the 9981 firms in the sample. The results are shown in Appendix C.

53. It will be seen that many of the charts show slightly lower levels of BAME in the two categories than in the whole sample. The largest differences tend to be in the BAME partners category. This would be consistent with the data in the SRA's diversity toolkit which shows lower BAME partner numbers in larger firms.

54. The figures are not directly comparable with those in the toolkit because they are the summary of the raw diversity data for appropriate segments. The data had two limitations - non-responses or those that answered 'prefer not to say'.

55. Based on some evidence in the toolkit, we can say that member of a minority group may be more likely to answer 'prefer not to say' in the case of ethnicity.

56. Therefore, the actual percentage of BAME in each chart below might have been undermined by the 'prefer not to say' responses reported.

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<sup>57</sup> Although this also includes some firms in the £200k -£400k bracket

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### **Conclusions from the provider fee modelling**

57. Any conclusions are inevitably tentative at this stage since we are attempting to predict behaviour in a very complex and changing market,
58. Subject to this, and to the caveats about the data referred to above:
- Whilst we believe that major short term changes are unlikely, it can be seen that potentially the main impact on fees could come from a relatively small number of firms in the 'top 200' moving non-reserved activity out of SRA regulation. These firms may be more likely to move work into separate businesses because of the high proportion of non-reserved services that they carry out.
  - If this happens, the small relative differences in ethnic make-up of these firms could cause a similar differential impact in terms of the impact of fees on remaining firms (particularly at partner level). This could happen if the fees formula was not adjusted and if the overall costs of regulation did not reduce.
59. We therefore believe that we need to keep this issue under review and monitor what happens in practice to ensure that any potential diversity impact (including in other diversity categories) on relative fees is taken into account as we review our fee policy. This issue will also form part of a review of the impact of these changes which we will publish within two years of implementation.

### **Increasing public understanding of citizens' legal rights and duties**

60. In so far as the removal of restrictions on forms of business increases access to services, it would tend to increase public understanding of legal rights and duties. Increasing the involvement of solicitors in the alternative legal services sector may drive up standards in that sector. However, as research has shown that private law consumers are confused about the extent to which legal services are regulated<sup>58</sup>, there is a risk that these measures might increase that confusion. The measures that we will take to address this risk are set out in the consumer impact statement.

### **Promoting and maintaining adherence to professional principles by authorised persons**

61. One of the arguments made against removing restrictions on separate businesses is that clients will be referred to the separate business when it is not in the client's interest because there is a financial incentive to do so. We agree with the LSB's analysis here:<sup>59</sup> "However, such incentives exist regardless of whether there are restrictions on authorised persons being connected with, investing in or owning a range of businesses. If there are restrictions, authorised persons could simply offer the same services from

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<sup>58</sup> Market analysis section 4

<sup>59</sup> [http://www.legalservicesboard.org.uk/news\\_publications/LSB\\_news/PDF/2014/20141009\\_Business\\_Restrictions\\_Report.pdf](http://www.legalservicesboard.org.uk/news_publications/LSB_news/PDF/2014/20141009_Business_Restrictions_Report.pdf)

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inside the legal services body or have a referral arrangement in place with an external party.”

62. In our view, the new Outcomes in the Code included in the new Chapter 12 will ensure that the professional principles are maintained. In particular, there will be duties only to refer and divide cases when in the client’s best interests and to obtain the clients informed consent to do so. ‘Informed consent’ includes making the client aware of any interest that the authorised person has in the separate business.
63. Of course, any rule may be breached by those who are acting dishonestly, as a number of SRA enforcement cases have shown with the current SBR<sup>60</sup>. It is important therefore that rules and mechanisms remain in place to protect clients and their assets when things go wrong. We will be obtaining information in the annual renewal form on separate businesses and will be monitoring this information on a risk basis and taking action where appropriate.

**Assessment against the better regulation principles**

*Transparent*

64. The different lists of prohibited and permitted activities in the current SBR can cause interpretation problems and are arguably insufficiently transparent. The need to grant a significant number of waivers to ABSs has also left its application in an unclear position. By removing restrictions on ownership and focussing on client protection we consider that the rule will be more transparent

*Accountable*

65. We consider replacing the need for waivers with a rule with clear principles will improve accountability

*Proportionate*

66. We consider that a restriction on taking part in separate business that impacts uniquely on SRA authorised persons is not a proportionate response to the potential client detriment issue i.e. client confusion and loss of protection. In our view, a rule that focuses squarely on those issues is a better approach.

*Consistent*

67. The extensive use of waivers to allow the current rule to operate and still comply with the regulatory objectives could lead to lack of consistency.

*Targeted*

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<sup>60</sup> See the consultation document for details

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68. We believe that that current rule does not target itself narrowly enough at the issues the SBR is there to deal with – client confusion and detriment through loss of protection - and that the replacement rule will do so more effectively.

**Appendix A**

**All open law practice head offices with a current recognition**

Number of partners	Does the firm do conveyancing, probate or personal injury work?*				All open law practices	
	Yes		No			
	Number	% of firm size doing work	Number	% of firm size not doing work	Number	%
1	2,443	51%	2,379	49%	<b>4,822</b>	<b>46%</b>
2-4	2,970	70%	1,261	30%	<b>4,231</b>	<b>40%</b>
5-10	708	75%	232	25%	<b>940</b>	<b>9%</b>
11-25	238	75%	80	25%	<b>318</b>	<b>3%</b>
26-80	108	88%	15	12%	<b>123</b>	<b>1%</b>
81+	53	88%	7	12%	<b>60</b>	<b>1%</b>
no open partner posts	24	46%	28	54%	<b>52</b>	<b>0%</b>
<b>Total</b>	<b>6,544</b>	<b>62%</b>	<b>4,002</b>	<b>38%</b>	<b>10,546</b>	<b>100%</b>

\* taken from approved RF1 applications from 2013-14

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Number of partners	Does the firm do any of; conveyancing, probate, personal injury, children, family matrimonial, debt collection, landlord & tenant or litigation other work?*				All open law practices	
	Yes		No			
	Number	% of firm size doing work	Number	% of firm size not doing work	Number	%
1	4,605	95%	217	5%	4,822	46%
2-4	4,077	96%	154	4%	4,231	40%
5-10	914	97%	26	3%	940	9%
11-25	312	98%	6	2%	318	3%
26-80	123	100%	0	0%	123	1%
81+	59	98%	1	2%	60	1%
no open partner posts	35	67%	17	33%	52	0%
<b>Total</b>	<b>10,125</b>	<b>96%</b>	<b>421</b>	<b>4%</b>	<b>10,546</b>	<b>100%</b>

Number of partners	Does the firm do criminal law work?*				All open law practices	
	Yes		No			
	Number	% of firm size doing work	Number	% of firm size not doing work	Number	%
1	843	17%	3,979	83%	4,822	46%
2-4	1,076	25%	3,155	75%	4,231	40%
5-10	261	28%	679	72%	940	9%
11-25	80	25%	238	75%	318	3%
26-80	28	23%	95	77%	123	1%
81+	10	17%	50	83%	60	1%
no open partner posts	7	13%	45	87%	52	0%
<b>Total</b>	<b>2,305</b>	<b>22%</b>	<b>8,241</b>	<b>78%</b>	<b>10,546</b>	<b>100%</b>

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**Appendix B**

DESCRIPTION	Treated as reserved for sample purposes
Arbitration and alternative dispute resolution	No
Commercial/corporate work for listed companies	No
Commercial/corporate work for non-listed companies and other	No
Consumer	No
Financial advice and services (regulated by FCA)	No
Financial advice and services (regulated by SRA)	No
Intellectual property	No
Landlord and tenant (commercial and domestic)	Yes
Property – commercial	Yes
Planning	No
Property – residential	Yes
Wills, trusts and tax planning	No
Bankruptcy / insolvency	No
Debt Collection	No
Discrimination / civil liberties / human rights	Yes
Employment	No
Litigation - other	Yes
Non-litigation – other	No
Personal injury	Yes
Children	Yes
Criminal	Yes
Family / matrimonial	Yes
Immigration	No
Mental health	No
Probate and estate administration	Yes
Social welfare	No

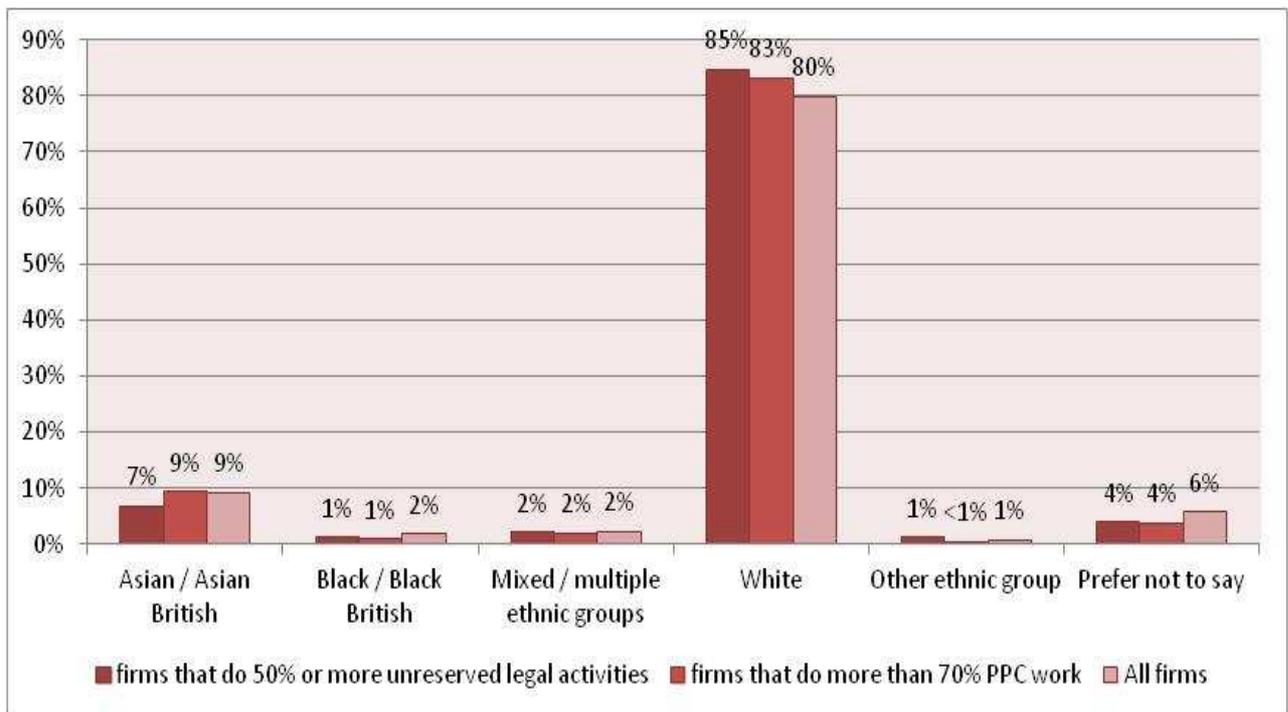
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**Appendix C: Ethnic breakdown charts**

**Chart 4: Solicitors and other lawyers<sup>61</sup> Ethnicity**



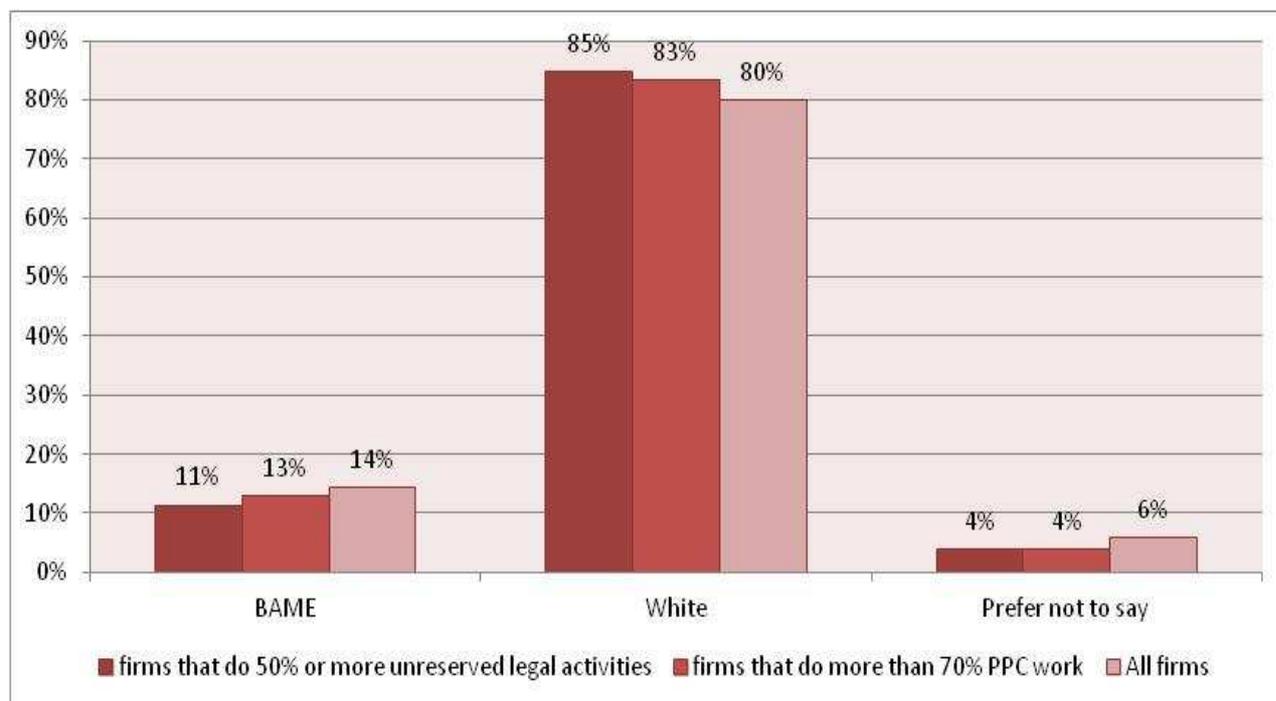
**Chart 5: BAME Solicitors and other lawyers**

<sup>61</sup> Solicitor, Barrister, Chartered Legal Executive/Legal Executive Fellow, Licensed Conveyancer, Patent or Trade Mark Attorney, Costs Lawyer, Notary

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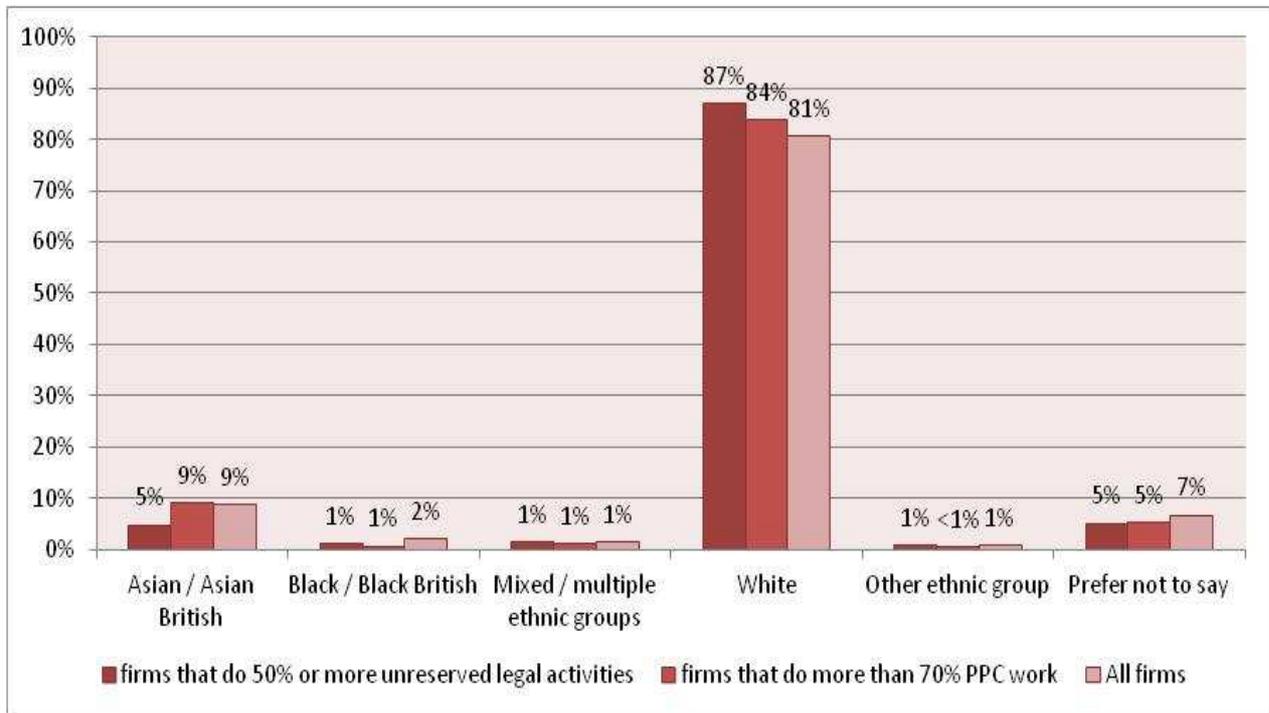


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**Chart 6: Partners<sup>62</sup> Ethnicity**



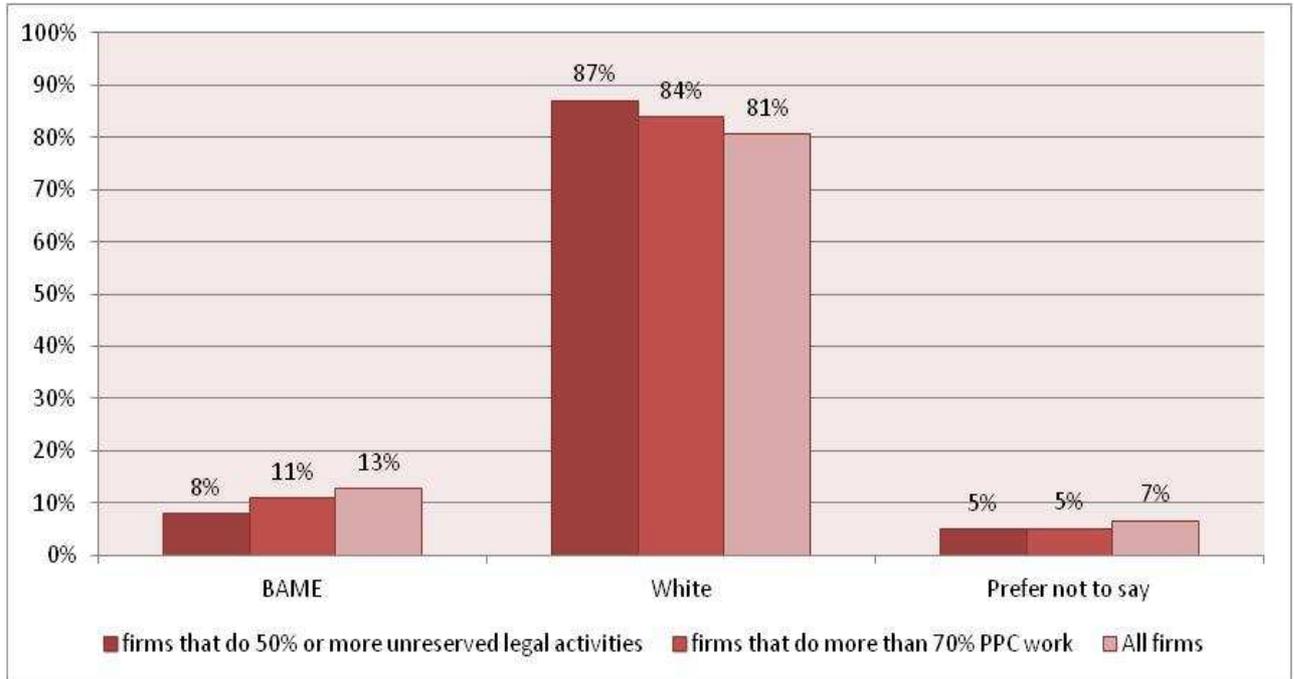
**Chart 7 BAME Partners**

<sup>62</sup> Solicitor sole practitioner, partner, member or director

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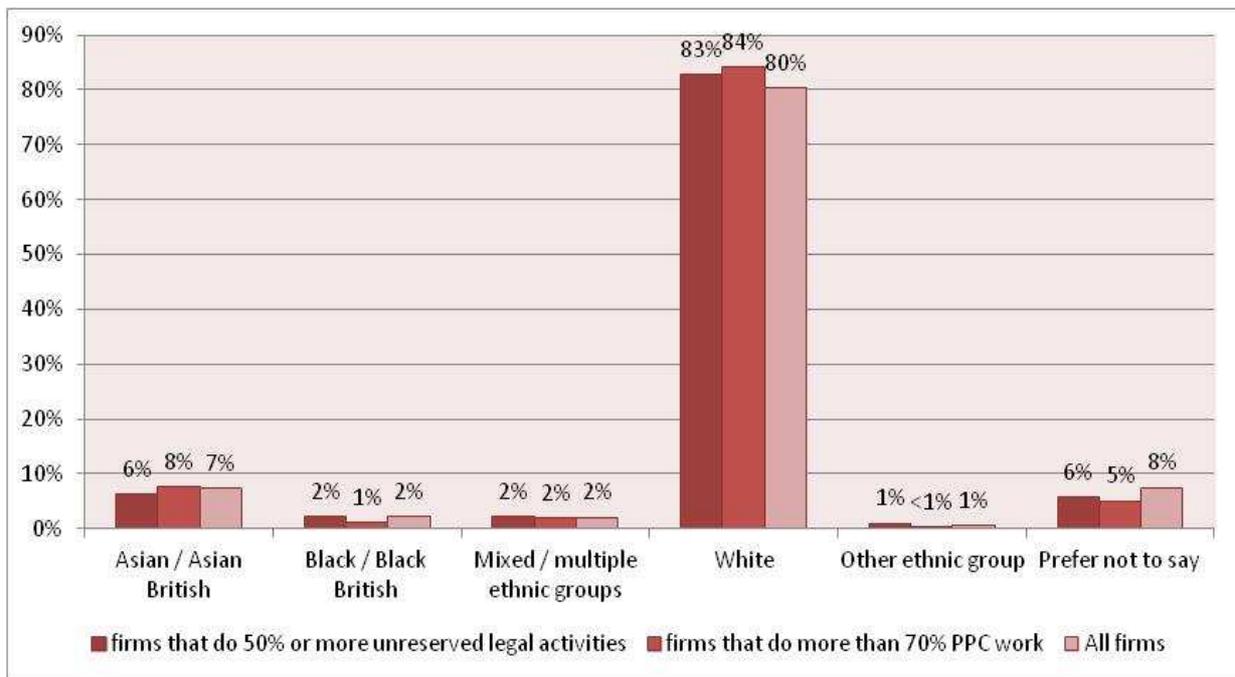


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**Chart 8: All (solicitors and other lawyers, partners and other employees<sup>63</sup>) Ethnicity**



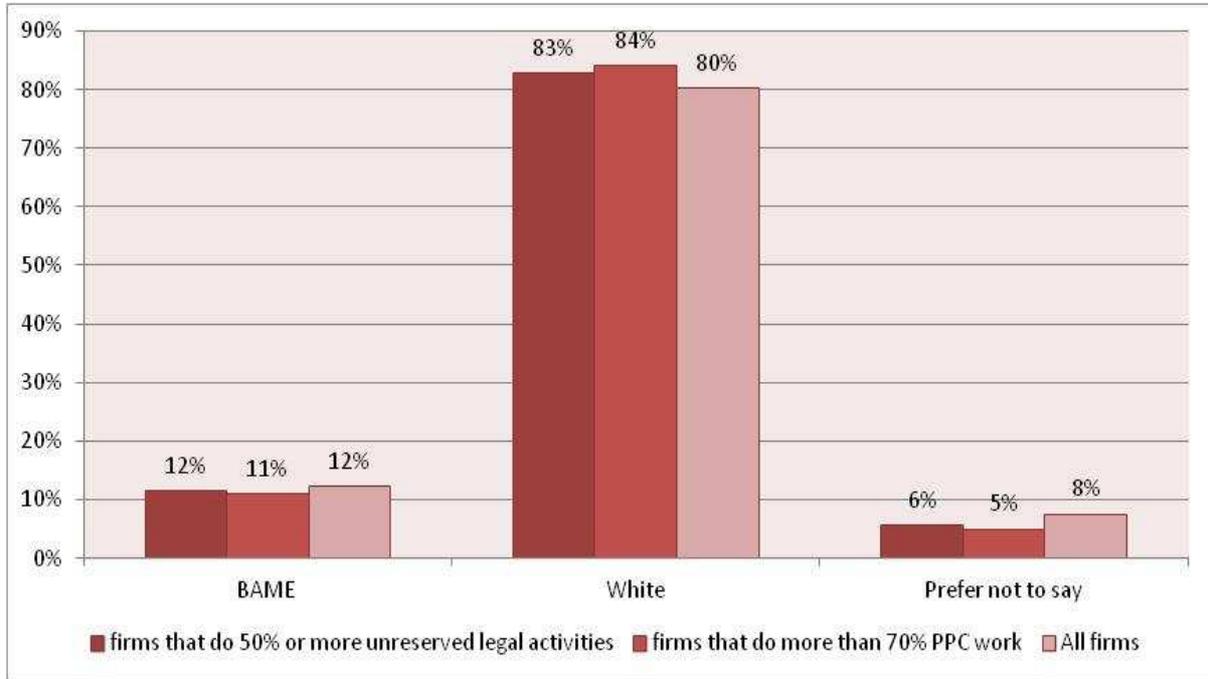
**Chart 9: All (solicitors and other lawyers, partners and other employees) BAME**

<sup>63</sup> Other fee earning role, role directly supporting a fee earner, managerial role, IT / HR / other corporate services role.

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**Draft SRA Amendments to Regulatory Arrangements (Separate Business and Services) Rules [2015]**

Rules dated [date of LSB approval to be inserted] made by the Solicitors Regulation Authority Board, under sections 31, 79 and 80 of the Solicitors Act 1974, section 9 and 9A of the Administration of Justice Act 1985 and section 83 of the Legal Services Act 2007 with the approval of the Legal Services Board under paragraph 19 of Schedule 4 to the Legal Services Act 2007.

**Rule 1**

Chapter 12 of the SRA Code of Conduct 2011 shall be replaced with the following:

**“Outcomes**

You must achieve these outcomes:

- O (12.1)** you ensure, and have safeguards in place to ensure, that *clients* are clear about the extent to which the services that you and the *separate business* offer are regulated;
- O(12.2)** you do not represent, directly or indirectly, the *separate business* as being regulated by the *SRA* or any of its services as being regulated by the *SRA*;
- O (12.3)** the *separate business* does not carry on:
  - (a) reserved legal activities; or
  - (b) *immigration work* unless that work is regulated by the Office of the Immigration Services Commissioner;
- O (12.4)** you only:
  - (a) refer, recommend or introduce a *client* to the *separate business*;
  - (b) put your *client* and the *separate business* in touch with each other; or
  - (c) divide, or allow to be divided, a *client’s* matter between you and the *separate business*,

where the *client* has given informed consent.”

**Rule 2**

In paragraph 13A.3 (j) of the SRA Code of Conduct 2011, replace “outcomes 12.3 to 12.6” with “chapter 12”.

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**Rule 3**

The SRA Handbook Glossary 2012 shall be amended as follows:

- (a) in the definition of “**connected with**”, replace “(i) having one or more *partner(s)*, *owners(s)*, *director(s)* or *member(s)* in common with the separate business” with the following:

“(i) where an *owner* or *manager* of an *authorised body* is a *partner*, *owner*, *director*, *member* or member of the governing body of the *separate business*”;

- (b) delete the definitions of “**permitted separate business**” and “**prohibited separate business**”; and

- (c) replace the definition of “**separate business**” with:

**“separate business**

means a business, wherever situated, which you *own*, are *owned by*, *actively participate in* or are *connected with* and which is not any of the following:

- (i) an *authorised body*, an *authorised non-SRA firm*, or an *overseas practice*; or  
(ii) an *in-house practice* or practice overseas which is permitted by the *SRA Practice Framework Rules*.”

**Rule 4**

Rule 13.2 of the SRA Practice Framework Rules 2011 shall be amended as follows:

- (a) after “business of a *recognised body*” insert “or recognised sole practice”;
- (b) at the end of paragraph (b), replace “,” with “; and”;
- (c) delete “but this does not prevent a *recognised body* providing services within Chapter 12 (Separate businesses) of the *SRA Code of Conduct*, or holding an interest in a *company* which is a *separate business*”;
- (d) insert paragraph (c) as follows:

“(c) the following services (whether or not they are also included in paragraph (a))

- (i) alternative dispute resolution;  
(ii) financial services;

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- (iii) estate agency;
- (iv) management consultancy;
- (v) company secretarial services;
- (vi) other professional and specialist support services to business including human resources, recruitment, systems support, outsourcing, transcription and translating;
- (vii) acting as a parliamentary agent;
- (viii) practising as a lawyer of another jurisdiction;
- (ix) acting as a bailiff;
- (x) accountancy services;
- (xi) education and training activities; and
- (xii) authorship, journalism and publishing.”; and

(e) replace Guidance note (ii) with:

“(ii) Rule 13.2 lists the services that can be carried out within a *recognised body* or a recognised sole practice: either solicitor services, notary services, services of a *lawyer* or as exceptions to these services under section 9(1A) of the Administration of Justice Act 1985. Professional services ‘of the sort that can be carried out by solicitors’ include any *legal activity* under the *LSA*. Nothing in Rule 13.2 affects any requirements that may be imposed by legislation or non *SRA*-regulation in relation to the listed activities. See also the *SRA Property Selling Rules 2011* in relation to estate agency services.”

**Rule 5**

These rules come into force on 1 November 2015 or the date of approval by the Legal Services Board, whichever is the later.

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**Draft Guidance on Chapter 12 of the SRA Handbook – the separate business rule (SBR)**

**Introduction**

1. The SRA does not regulate separate businesses. However, authorised persons that have connections with them are regulated, and the nature of those connections is regulated. Actions by the separate business may lead to you being in breach of SRA rules, especially where you have an element of control over the separate business or you actively participate in it.
2. You will always be responsible for your own services and publicity to clients and for the extent to which you refer clients to separate business or divide cases with them, and you must always act in the client's best interests. There may be some circumstances where you should terminate your links with the separate business altogether; for example where you consider that the separate business lacks integrity or lacks competence to deal with the cases that it is taking on.

**Outcome (12.1)** you ensure, and have safeguards in place to ensure, that *clients* are clear about the extent to which the services that you and the *separate business* offer are regulated.

**Outcome (12.2)** you do not represent, directly or indirectly, the *separate business* as being regulated by the SRA or any of its services as being regulated by the SRA.

3. Although Outcomes 12.1 and 12.2 apply to you, taking steps to comply will mean ensuring that the publicity and information given by the separate business allows compliance. If you are unable to achieve this then it may be necessary for you to terminate your connection with the separate business.
4. The extent of the information to be provided to meet these Outcomes will depend on the likelihood of the confusion arising.
5. The more obviously 'separate' the business, and the further away its activities are from legal activities that consumers might expect to be provided by a lawyer, then the less detail will need to be provided.

*Example: W & Co (a recognised body) are part owners of G Properties (an estate agency). The two businesses do not share premises, staff, publicity or a website, although referrals occur between the two businesses. G Properties do engage in some legal activity that is routine for estate agents – for example, providing draft*

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*leases to residential landlords. However, cases are never ‘split’ between the two firms and W & Co only refer clients for estate agent activities.*

*There would seem to be little risk of consumers being confused as to the nature of regulation of the different entities. So for example, it should be unnecessary for G Properties website or other publicity to state that G Properties are not regulated by the SRA. When referring clients to G Properties, W & Co will need to comply with Outcome 12.4. However, this could involve a reference to G Properties being an estate agent and as such not regulated by the SRA, but would generally not need to involve detailed information about the differences in regulation. However, the nature of the links between the two businesses must be made clear on any referrals and the outcomes in Chapter 6 of the Code (introductions to third parties) must be complied with.*

6. Factors that will require more specific information to be provided to consumers will include:
  - (1) You and the separate business sharing:
    - the same or a similar name; and/or
    - premises; and/or
    - staff – especially if the staff will deal directly with consumers
  - (2) You and the separate business having shared (or linked) websites, contact details or publicity.
  - (3) The extent to which the separate business provides legal services that consumers would expect to be provided by a lawyer.
  - (4) Whether clients seeking legal services will be first directed to the separate business.
  - (5) Whether matters will be divided between you and the separate business –see also Outcome 12.4

*Example: R Solicitors own R Estates, a separate business. The two firms share a website which directs clients that require estate administration or probate services to R Estates via e-mail contact or a helpline number. These clients are only referred to R Solicitors in order to obtain the grant of probate, and R Estates deal with the administration throughout. This will bring into play Outcome s.1, 12.2 and 12.4. The website itself will need to explain clearly that R Solicitors are regulated by the SRA and that R Estates are not. However, there will be a need to go further and obtain the client’s informed consent to the matter being divided between the firms and provide specific information as to the differences in regulation and redress. See paragraph 13 below.*

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7. The duties in Outcomes 12.1 and 12.2 are continuing. For example, if a client has instructed both you and separate business then that client should be clear throughout about the extent to which the different elements of the work are regulated and about who is performing each element.

**Outcome (12.4) you only:**

- (a) refer, recommend or introduce a *client* to the *separate business*
- (b) put your *client* and the *separate business* in touch with each other; or
- (c) divide, or allow to be divided, a *client's* matter between you and the *separate business*,

**where the *client* has given informed consent.**

8. What will constitute the client's 'informed consent' will depend on the circumstances.
9. 'Informed consent' will always involve the client being made aware of the nature of your links to the separate business and any interest you have in making the referral<sup>64</sup> However, if the referral is to a separate business for a separate matter, not involving legal activities, then it may be unnecessary for detailed information about regulatory redress to be supplied. Clearly, you will require the client's agreement before passing on details to the separate business – but the client may of course contact the separate business him or herself having been given the appropriate information.<sup>65</sup>

10. *Example:*

*RTA & Co handles personal injury claims. They are part of a group of companies which includes a separate business 'Fast Car' that hires out cars following accidents. RTA & Co can recommend Fast Car for car hire to their personal injury clients provided that it is in the client's best interests to do so, that the provisions of Chapter 6 of the Code of Conduct, relating to introductions to third parties, are satisfied and the client understands the nature of the links between the two businesses. The client's agreement would be needed to pass their details to Fast Car.*

11. If a matter is divided with a separate business or the referral is for the primary purpose of the separate business carrying on legal activity, then the client needs to be made aware of the differences in regulatory protection and of redress between the two businesses. The concept of informed consent includes the client understanding the consequences of these differences, not just the fact of them. This is likely to

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<sup>64</sup> For the purposes of this guidance the terms 'referral' or 'referring' cover all of the circumstances in O12.4 (a) and (b)

<sup>65</sup> See also the obligations in Chapter 6 of the Code

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require going further than the more general obligations in Outcomes 12.1 and 12.2, which apply in all cases.

12. In these circumstances, the information will need to be at an appropriate level of detail and explicitly drawn to the client's attention, for example in a client care letter, rather than just being one of the terms of engagement or contained in terms and conditions on a web page.
13. The starting point is that clients should be informed that the work carried out by the separate business will not be regulated by the SRA and that:
  - There will no right to complain to the Legal Ombudsman
  - There will no right to claim on the Compensation Fund
  - The work will not be covered by compulsory PII (you may explain what insurance arrangements the separate business has in place)
  - The work will not be covered by legal professional privilege
  - The protections in the Accounts Rules in relation to client money will not apply.
14. This is only a starting point – the test is whether the client has actual understanding of the differences in regulation and redress and the potential consequences and it is your responsibility to ensure that this is the case.
15. Where there are factors increasing vulnerability, it may well be necessary to explain these issues in more detail to be sure that the client understands the potential consequences.
16. Where the separate business is regulated elsewhere then the information may be amended to reflect the protections and rights of redress offered by that regulation. For example, other professionals will often have their own compulsory PII schemes, and those instructing regulated Claims Management Companies have the right to complain to the Legal Ombudsman.
17. Other factors that may be taken into account in deciding the appropriateness of the information is the client's existing knowledge and whether the client would have a reasonable expectation that protection relating to legal services would apply. In some circumstances, certain elements of the information will not be relevant or necessary. For example, business clients with a turnover of £2m or more will not have the right to access the Legal Ombudsman or the Compensation Fund in any event. However, all clients are entitled to clarity about their regulatory position and the information provided should be sufficient so that they can understand the risk they are taking on – including the potential loss of legal professional privilege.

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### **Considering the client's best interests**

18. Under principle 4 of the SRA Principles 2011, you are obliged to act in the best interests of your client and you need to consider this carefully when Outcome 12.4 applies.
19. Where you are making a referral of all or part of the matter to the separate business, the fact that it may be in the client's best interests for you to refer them elsewhere (e.g. because you do not have expertise in the particular area) does not necessarily mean it is in their best interests to refer them to the separate business. It might, for example, be in the client's best interests to refer to another LSA regulated business.
20. Factors that you will need to consider when deciding whether it is likely to be in the client's best interests to refer to, or divide the matter with, the separate business will include:
  - The importance of retaining regulatory protections available to an authorised person in the particular case
  - What other regulatory protections exist in the separate business
  - Whether client money is to be held by the separate business and whether adequate protections will be available
  - Whether it is likely to be important to retain legal professional privilege
  - Whether dividing (or allowing to be divided) the matter is likely to lead to uncertainty as to who is managing the matter or aspects of the matter or as to what protections exist in any particular circumstances.

### **What is the same 'matter'?**

21. It is not possible to give an exhaustive definition of a 'matter'. This will often be a question of what the client's reasonable expectations would be – i.e. would the client reasonably regard it as the same matter.
22. However, in our view the following will always be part of the same matter for these purposes:
  - The grant of probate and administration of the estate
  - All legal activity in relation to conveyancing
  - All legal activity in relation to the same cause of action in a civil dispute
  - All legal activity in relation to a family dispute.

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23. It is important to note that Outcome 12.4 does not apply where work is outsourced to the separate business i.e. you retain conduct of and responsibility for the whole matter.<sup>66</sup>

**Allowing a matter to be divided**

24. In the context of Outcome 12.4 (c) we are concerned with a legal matter. So, giving legal advice to a client in relation to an aspect of a separate non-legal service provided by a separate business is not dividing or allowing a matter to be divided with that business.

*Example: A client has instructed the separate business (a financial services firm) to provide investment advice. At a certain point the separate business refers the client to the connected authorised person for advice on the tax implications of the investments. The authorised person accepting the instructions does not constitute allowing a matter to be divided with the separate business.*

25. There will be many circumstances where a client has directly instructed a separate business to handle a matter that primarily involves legal activity. At some point in the case it may be in the client's best interests for a regulated lawyer to be involved, for example, to provide reserved services or specialist advice. In those circumstances, Outcome 12.4 will apply and you will require informed consent and will also need to ensure that Chapter 9 of the Code (relating to fee sharing and referrals) is complied with.

*Example: The client instructs a debt recovery company (the separate business) to pursue a debt. When it becomes necessary to issue litigation, the client is referred to the connected SRA authorised body, but separate business continues to handle certain aspects of the matter and correspond with the client. The authorised body will be allowing the matter to be divided with the separate business, and there will be a requirement to obtain informed consent under Outcome 12.4.*

26. It may sometimes be in the client's best interests for you to take over conduct of the whole matter from the separate business rather than just a part. This could be where, for example, it would be difficult for you to provide a reserved service to the client effectively unless you had full conduct of the matter, or where the client's interests are likely to be seriously prejudiced unless they benefit from legal privilege in relation to the whole matter. In those circumstances you should refuse to act unless the separate business is willing to refer the whole matter.

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<sup>66</sup> But see Outcomes 7.9 and 7.10 in relation to outsourcing.

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**Some other key issues relating to separate businesses**

27. **SRA Principle 3: not allowing your independence to be compromised.** The interests of the separate business should not be put before the best interests of the client. Where you are dividing a matter with the separate business, you will need to ensure that you are able to act independently – so that, for example, where you represent the client in litigation you and not the separate business have actual as well as formal conduct of the litigation.
28. **Conflicts of interest.** Own interest conflict (see Outcome 3.4) will include situations where the referral to, or division of the case with, the separate business would benefit the separate business but is not in the client's best interests.
29. Potential conflicts of interest between clients (see Outcome 3.5). The separate business will be a separate entity and therefore you are able to act for clients who may be in conflict with clients of the separate business. However, issues may arise where information is shared between the businesses or members of staff work in both businesses.
- Example: The recognised body (Firm A) and the separate business (Firm B), have a shared director. That director considers a complaint from a client of Firm A and, in reviewing the file, becomes aware of information that impacts on another client he knows about in Firm B. That is the point at which conflict would become an issue. We would expect Firm A to have suitable policies and procedures in place to identify when such a conflict could occur, i.e. through which person and in what circumstances, how they will reduce the risk of such conflict occurring, and what they would do should such conflict occur.*
30. **Confidentiality requirements –Chapter 4 of the Code.** Separate businesses that are closely linked to the authorised body, whether or not they share premises, may bring a number of risks to confidentiality. These include:
- (a) IT systems. If you share an IT system with a separate business it is important that this is suitably secure and set-up so that only you can access your firm's client information and cases.
  - (b) Telephones - clients should always be clear which firm they are speaking to. Ideally, there will be separate phone numbers for you and the separate business.
  - (c) Sharing of information – you cannot share information with the separate business (or vice versa) without the client's consent.
31. The client's consent to waving their confidentiality must be clear and they cannot be forced to do so - this means a client confidentiality waiver should never form part of your general terms and conditions which clients must agree to enter into a retainer. A request to the client for consent to waive their confidentiality must be clear in, for

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example, the engagement letter and be separate from agreement to any other terms. It is important to consider that a waiver of confidentiality could lead to a loss of legal professional privilege and it may not be in the client's best interests to be asked to agree to it.

32. **The SRA Accounts Rules 2011** – the client account must not be used to hold money for the separate business.
33. **Participating or practising in a separate business.** Authorised Persons can be managers or employees of a separate business. However, you cannot practise as a solicitor, REL or RFL in a separate business except as permitted by Rule 4 (In-house practice) of the SRA Practice Framework Rules 2011.<sup>67</sup> .

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<sup>67</sup> See Rules 1 – 3 and 4 of the SRA Practice Framework Rules 2011.