

Consultation response

SRA: Separate Business Rule

Overview

- 1. The Separate Business Rule (SBR) is not delivering the consumer protection it is supposed to in its current form, while the existing practice of issuing waivers is neither fair nor sustainable in the long term. Ultimately, the SBR only needs to exist because the reserved activities lack a consumer protection rationale. The overall direction of travel should be to reform the wider regulatory system. However, such change is uncertain and its implementation many years off, so the SRA is right to review the SBR now.**
- 2. Determining the consumer interest in these issues is not straightforward. The proposals require us to contemplate sacrificing some consumer protection in exchange for extending access to justice, and assessing the efficacy of the proposed remedies. The absence of any consumer testing or quantification of the benefits makes this assessment harder.**
- 3. The key arguments in favour of the proposals are reducing the cost of legal services, stimulating new entrants and market innovation, and widening choice – all of which can be expected to tackle the very serious issue of large amounts of unmet need. The main arguments against lifting the current restrictions relate to consumer confusion and loss of protections due to non-reserved work increasingly being delivered by separate unregulated businesses.**
- 4. We welcome the proposed remedies but have concerns as to whether these will work effectively in practice. Solicitors have weak incentives to comply with the information remedies given consumer preferences to use regulated entities and their strongly held assumptions that the scope of regulation is all-encompassing.**
- 5. On balance, we give qualified support to the SRA's proposals conditional on the safeguards being strengthened and the information remedies being subject to rigorous consumer testing. Areas to strengthen include guidance on practical situations when referrals would not be in the client's best interests, prohibiting referrals from unregulated to regulated entities in certain circumstances and ensuring that prohibited referrals cover all high risk areas of law. Promoting access to redress, either through rules or informal leverage is crucial. 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.**
- 6. We support the proposals to extend the range of services that can be provided by solicitors firms on the grounds of wider choice and consumers benefiting from delivery of one-stop shop advice.**

The proposals

7. The SRA is proposing changes to the separate business rule (SBR), which forbids solicitors from having defined links to certain separate businesses, in particular those that specialise in providing non-reserved 'mainstream' legal activities. An exception is where advice is provided as an incidental part of a business.
8. The SRA proposes to retain the SBR in a revised form. It wishes to remove the prohibitions on links with separate businesses that carry on non-reserved legal activities and instead focus the rule on three outcomes that authorised persons must ensure to achieve consumer protection:
 - Ensure, and have safeguards in place to ensure, that clients are clear about the extent to which the services that the authorised person and the separate business offer are regulated;
 - Not represent directly or indirectly the separate business as being regulated by the SRA or any of its activities as being carried on by an individual who is regulated by the SRA; and
 - Only refer a client to a separate business when it is in the client's best interests to do so and when the client has given informed consent to the referral and has been informed of the authorised person's connection with the separate business
9. In addition, referrals will be forbidden from the authorised person to the separate business in certain circumstances, in order to prevent regulated providers from gaining a client's instructions, only to then hive off

the case to an unregulated separate business. Further, to minimise consumer confusion, solicitors that provide services to the public within a separate business will no longer be able to describe themselves to clients as 'non-practising solicitors'.

10. The consultation makes separate proposals to widen the services that can be provided by solicitors firms within their practice to include: professional and specialist support services to business including human resources, recruitment, systems support, outsourcing, transcription and translating; and accounting services.

The Panel's response

11. The Panel has considered these issues afresh by applying our consumer principles framework. This is a finely balanced matter which requires us to contemplate sacrificing some consumer protection in exchange for extending access to justice, and assessing the efficacy of the proposed remedies. Regrettably we must do so in the absence of consumer engagement to inform the design of these proposals, or a quantified estimate of the benefits from competition which may ensue from changes to the rule. A mind map to demonstrate the range of benefits and drawbacks we have identified can be found at the end of this document.
12. In addition, we have applied our overall regulatory philosophy as stated in our work programme: *"We seek to find the right amount of regulation to enable consumers to truly benefit from open and fair markets. Both too much and too little regulation harms consumers. We want to remove unnecessary restrictions that impede innovation and increase the price of legal*

services. Yet consumers will have the confidence to drive competition only if they think regulation will protect them, so a strong and effective consumer protection framework is also needed”.

The separate business rule

Wider context and direction of travel

13. The Panel’s preferred end point is that the regulatory framework is based on a sound consumer protection rationale. As outlined in our response to the Ministry of Justice simplification review, there should be a system where consumers could access redress across all legal work and various extra layers of regulation would apply depending on the legal activity based on considerations of risk. Were such a framework in place, there would be no need for a separate business rule at all.
14. Recently the Lord Chief Justice told the Justice Select Committee that the current reserved activities should be reviewed following the general election. The SBR illustrates the difficulties that are caused by the existing division between reserved and non-reserved work. This consultation exercise adds weight to the need for the next government to commence a review and bring forward legislative change.
15. However, we recognise that fundamental change of this nature is uncertain to happen and would be many years ahead even with a fair wind. It is clear that the SBR in its current form has fallen into disrepute. The various lists of what is and isn’t permitted for solicitors to do is rather arbitrary and the current system of waivers is a sticking

plaster that helps no-one. Therefore, the SBR is not delivering the consumer protections it is supposed to and SRA is right to seek a better alternative. The question for the Panel is whether the proposed safeguards will be effective and result in wider choice and improved access, or if it would be better to make relatively minor changes and persist with the current approach (as an interim measure until legislative change).

The main arguments

16. Below we outline the strongest arguments for and against the SBR before turning our attention to the safeguards and then reaching an overall conclusion.
17. The Panel is acutely conscious of the high levels of unmet legal need which prevents large sections of the population from getting the expert help they need to resolve the everyday legal problems that they face. 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. Not only do regulatory costs related to the SBR have to be considered, but also the total costs of requirements, such as insurance and compensation arrangements, that set regulated and unregulated entities apart.
18. The SBR can also be argued to limit choice and have a chilling effect on innovation. Greater competition and new types of service provision should narrow the access gap described above. In particular, we see that the SBR could deter entry from MDPs currently doing a mixture of non-legal and unreserved legal work, who in order to offer reserved work would need to obtain an ABS

licence but then not be allowed to be connected to their existing businesses. Entry by MDPs has not transpired to the extent hoped, but the one-stop shop model they offer could transform legal services. Similarly, traditional high street practices could be freed up to innovate by offering non-reserved work from a separate unregulated business.

19. So the strongest arguments against the SBR relate to widening access and choice and facilitating innovation. However, these have to be balanced against the drawbacks of lifting current restrictions. The most serious drawbacks are loss of protection and increasing consumer confusion. When assessing these drawbacks, we must then consider if effective safeguards can be introduced to protect consumers at an acceptable level and still gain from the benefits derived from relaxing restrictions.
20. It is widely accepted that the current list of reserved work is an accident of history and not based on any consumer protection rationale. The SRA's rules, which include the SBR, paper over this situation by ensuring that all legal work by solicitors is regulated and solicitors cannot hive off the non-reserved work to separate businesses where the various protections which consumers enjoy would no longer apply. Drafting a will, obtaining advice when faced with eviction from a home or relationship breakdown, and setting up a business are just some examples of non-reserved work which can have serious financial and personal consequences for the consumer and third parties involved in the matter. The SBR, despite all its imperfections, means that consumers are protected when using solicitors for this work; this would not always be true if the proposals proceed.
21. This drawback is balanced against the SRA remedy which prohibits referrals in certain areas of law and evidence from the Market Analysis document that private client work tends to be clustered around reserved and closely related-activities, which makes it less likely that solicitors will seek to hive off non-reserved work. In addition, we would hope that most solicitors would not wish to lose the status associated with regulation and appreciate that consumers expect law businesses to be regulated and this will influence their choice of provider. Hence, while we have concerns about traditional firms shifting much of their work to separate unregulated businesses, there is some evidence to suggest this is unlikely to happen to a significant degree in practice.
22. Of course, consumers could still choose between a solicitor working in a regulated entity, a solicitor working in an unregulated entity and an unregulated entity which has no connection with a solicitor. Aside from issues of this being an informed decision, which we deal with next, the freedom of choice argument is not clear cut in practice. Our tracker survey reveals high levels of choice dissatisfaction in areas where intermediaries, such as estate agents and financial institutions, exert an influence over or restrict choice. Consumers could increasingly find themselves pushed, perhaps unwittingly, to using unregulated businesses for these transactions. Should the SRA give attention to these issues, this would help to allay our concerns here.

23. It does not follow that unregulated equals bad advice and regulated equates to good advice – the Panel’s previous work on will-writing services has indicated similar quality levels across the regulated and unregulated sectors. However, the differences include that consumers can obtain redress if things go wrong with a regulated business, but not necessarily with an unregulated one. Access to redress is a crucial consideration for us, due both to its ability to compensate individuals affected and its deterrent effect on market behaviours, so we return to this in our discussion around safeguards below.
24. Unregulated businesses are subject to general consumer law and consumer rights are being strengthened. While not wishing to diminish the importance of this, there are some clear limitations. Our research shows that dissatisfied consumers are much less likely to complain about lawyers than other service providers, so the likelihood of most people having the confidence to take a lawyer to court seem slim. Increasingly, trading standards have fewer resources to enforce the law and legal services is not a current enforcement priority. Further, general consumer rights cannot substitute for all the protections that the SRA brings, including preventative measures such as education and training, and remedial measures such as access to the Legal Ombudsman and the compensation fund. Again, this analysis underlines the need for the SRA to deliver (within the constraints of its powers) access to redress through ADR processes wherever possible.
25. Another argument in favour of the SBR relates to consumer confusion. Separate research by the Panel and SRA reveal that consumers assume all legal services are

regulated and these strongly held beliefs will be difficult to overcome. As the consultation document suggests, especially where clients seek a combination of services from a law firm structured as a separate business, they may mistakenly believe that they have regulatory protection for all activities when in fact they only receive it for the reserved work. There is some scope for confusion now since some exceptions within the SBR already exist and there is a reasonably large unregulated market, but at least the key mainstream legal activities are captured within the SBR as it stands. A key consideration is whether information remedies will work successfully.

The safeguards

26. To recap, the proposed safeguards include prohibiting referrals in certain situations, permitting referrals only when this is in the client’s interests and with their informed consent, and information remedies so that consumers are not misled about the level of protection they are getting. All these safeguards are welcome, but we question their efficacy in some respects and would like to see them strengthened.
27. The prohibitions would prevent referrals from reserved probate work to an unregulated estate administration entity, and acting for the client in the same matter in administration services in relation to: conveyancing; litigation support services involving legal activity; and pre-litigation services involving legal activity in family disputes (except mediation).
28. The Panel agrees that referrals in all these situations should be prohibited, but we would have liked to see a risk assessment across legal activities to identify the highest

risk areas (which the SRA may well have done internally). There are other areas, such as debt collection, which we would consider as high risk given the vulnerability of the client base, where referrals should also not be allowed. Immigration is another area, although presumably the Office of the Immigration Services Commissioner would pick up entities not regulated by the SRA.

29. We also note the referrals prohibition only relates to referrals *from* the regulated entity *to* the unregulated entity. In fact, it seems just as likely that referrals will flow in the opposite direction. Solicitors could own or be connected to unregulated businesses that have large marketing budgets to entice consumers and would only need to make referrals for the narrow reserved element. Since these unregulated businesses could have brand names that sound much like the connected regulated entity, this could be very confusing for consumers. In our view, the referral prohibitions should work in both directions. This prohibition would only apply to connected businesses and therefore be targeted on those specific practices around enticement; it would not prevent referrals between unregulated and separate regulated businesses that are an existing and normal feature of the market.
30. Solicitors have an overriding duty to act in the best interests of their client. It would be helpful for the SRA to set out under what sorts of situation this very broad principle should stop a solicitor from making a referral; any such guidance would of course be non-exhaustive, but nonetheless it would provide useful clarity. Further, we would be interested to explore whether this principle could be used as leverage to influence when referrals take place and the practices of the unregulated business. For instance, would the solicitor fail to act in the client's best interests if they referred clients to an entity which either was uninsured or did not subscribe to an independent consumer redress mechanism?
31. Therefore it is possible that the SRA could use its rules to deliver redress where there are referrals. In addition, we would like the SRA to use its leverage to promote access to redress where referrals do not happen, but solicitors deliver non-reserved services from separate unregulated businesses. The ADR Directive, which comes into force in July of this year, gives consumers the right to access ADR for all legal transactions but makes it voluntary for providers to take part unless sector specific regulation mandates otherwise. Participation will depend on the strength of incentives and encouragement. The Panel's 2020 report and the LSB's new draft strategy both call for effort to address consumer detriment in the unregulated sector. In our view, along with other bodies, the SRA has a responsibility to proactively promote access to redress. To be clear, in the absence of a voluntary scheme run by the Legal Ombudsman, providers should be encouraged to subscribe to recognised schemes that already exist so that consumers have a vehicle for redress.
32. Ensuring that clients are aware of the differences in consumer protection and give their informed consent to referrals are vital. Further, as a consumer body, we recognise issues around personal responsibility and a desire to give people the freedom to take risks. Our current work on unbundling legal services involves consumers accepting risk by doing some tasks alone, but benefiting from the limited advice that they can afford.

33. However, we are cautious about the likely success of these safeguards. Compliance with the information remedies runs counter to the solicitor's commercial interests since they know that clients may well demur when presented with an unregulated option. The SRA's own data shows that solicitors firms have a poor record on compliance with information remedies; the misconduct cases highlighted in the consultation illustrate the sorts of problems. The SRA does not appear to have subjected its proposals to consumer testing, the results of which may have allayed our concerns. We would like to see a gap analysis of the state of consumer confusion now versus the state of consumer confusion with the change. Would this result in increased understanding? Do the intended information remedies and increased engagement and discussion with the client actually bring to life the lost or gained protections? Does this differ by type of consumers? And, so on.
34. More generally, the regulatory and redress landscapes are becoming more fragmented over time. We would welcome a separate initiative across the approved regulators, learning from approaches in other sectors such as financial services, which would lead to a common approach designed to help consumers know when their provider is regulated and when they are not – and the implications of these differences.
35. Finally, we welcome the safeguard that solicitors that are on the Roll and that provide services to the public within a separate business will no longer be able to describe themselves to clients or potential clients as 'non-practising solicitors'. This term is open to abuse from practitioners who could seek to give a misleading impression of their regulatory status. Prohibiting the term in this setting is a common sense mechanism to mitigate problems around consumer confusion.
- ### Conclusion
36. Having weighed the arguments, the Panel gives qualified support to the SRA's proposals to revise the SBR but our support is conditional on the safeguards being strengthened as outlined above.
37. Areas to strengthen include guidance on practical situations when referrals would not be in the client's best interests, prohibiting referrals from unregulated to regulated entities in certain circumstances and ensuring that prohibited referrals cover all high risk areas of law. Promoting access to redress, either through rules or informal leverage is crucial.
38. 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.
39. We also expect to see an active supervision regime put in place, at least in the first few years as the market adapts to change.
40. The Panel remains concerned about loss of consumer protection and the increased scope for confusion. However, the SBR has become anachronistic in an economy where there is consumer demand for legal and non-legal services offered through a

variety of business models. We are also swayed by the need for radical changes to unlock the competition and innovation that is urgently required to address the huge levels of unmet need. With a strengthened set of safeguards than currently proposed and active monitoring, the substantially revised SBR would seem a proportionate response to the risks facing consumers.

41. However, we end by going back to where we started: the SBR underlines the flaws in the current regulatory framework and we view these changes as a necessary interim measure while work is undertaken to create a new regulatory framework which is based on a sound consumer protection rationale.

Widening the services that can be provided by solicitors firms

42. The Panel can deal with this separate issue quite briefly. Our remit is confined to legal services; we do not represent the interests of consumers using accountancy and other non-legal services. However, from the perspective of a legal services consumer, there are clear advantages in enabling providers to offer one-stop shop advice, especially where consumers reasonably expect these services to be delivered together with solicitor services. The SRA will want to assure itself that solicitors are competent to provide these additional services and that it has the expertise and tools to fulfil its regulatory responsibilities. Overall we see this as enhancing choice and service delivery for consumers.

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