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Legal Services Act – New forms of practice and regulation

Comments by Mark Boleat

Introduction

1. On 5 November 2007, the Solicitors Regulation Authority (SRA) published this consultation document setting out proposals for changes to the structure and regulation of legal practices that will be enabled by the Legal Services Act 2007. Comments are invited by 14 December.

2. This paper is a personal response by Mark Boleat. He has relevant experience as a former director general of three major trade associations and executive chairman of two associations, author of a number of papers on consultation and policy making, member of the National Consumer Council for six years, member of the Gibraltar Financial Services Commission and as a temporary civil servant with responsibility for implementing the regulation of claims management activities under the Compensation Act 2006. In this latter position he had first hand experience of the way that regulation of solicitors currently operates.

Summary

3. The paper is of major importance, setting out the strategy for changes to the regulation of solicitors. As is generally the case the strategy is vitally important; if this is wrong then there is no chance of the final outcome being unsatisfactory. The consultation seems a little low key given the importance of the issue.

4. The design principles for the new regime are broadly satisfactory. However –

- The move to regulation of the practice rather than the individual is essential, but it is not clear that the SRA has fully thought through how this will work and the implications of it.
- It is necessary to reform the disciplinary process which at present is so structured as to be ineffective. The SRA must be able to impose sanctions directly.
- "Passporting" of existing firms into the new regime is inherently undesirable and would be a missed opportunity to get the new regime off on to a proper footing.
- The word "manager" should not be used to mean very different things such as "investor" and "director".

The major proposal

5. The most significant change that it is being proposed is for legal practices to be regulated as practices rather than regulation being almost entirely of individual solicitors. This is essential, long overdue and very welcome. The present arrangements have led to a culture in which partners in a solicitors' practice can benefit from the proceeds of malpractice of their colleagues while never having to take responsibility. The reason

why systematic malpractice (for example in respect of breaches of the rules on referral fees) has been allowed to continue for so long is partly because there is little incentive on a practice to ensure that every part of the practice is operating within the rules. This is in contrast to normal commercial practice where the board and management of the business is responsible for each part of the business.

6. Under the new arrangements all the partners in a firm and the firm as a whole must be jointly and severally liable for everything that goes on in the firm. This would reflect the position in other regulated sectors and should help ensure that within a firm those responsible for owning and managing it should put in place the necessary compliance arrangements.

7. Para 3.1 has a strange comment in this respect: "rules and sanctions which apply to an individual within a firm (including an LDP) will apply to all individuals within the firm, including non-solicitor partners and non-solicitor employees". This is not the way that it should work. Rather, the rules and the sanctions should apply to the firm as a whole. If there is a sufficient evidence that an individual acted improperly then it may be appropriate for action to be taken against that person as well, but generally any action must be against the firm.

The missing proposal

8. Most regulators have the power to impose sanctions on the firms they regulate – generally extending to removing their licence to operate. There is then a right of appeal to an independent tribunal. This is the case for example for the Financial Services Authority and also for the Claims Management Regulator established under the Compensation Act 2006. By contrast, the SRA has to prosecute before a tribunal. This is a very lengthy and costly process. Solicitors engaging in malpractice, which in some case extends to facilitating serious crime, know this and correctly perceive that they can get away with malpractice for years and probably for ever.

9. This has been amply illustrated by an SRA monitoring exercise conducted in 2006 which showed widespread non-compliance with the referral fee rules. The most recent report to the SRA Board, in June 2007, reported on follow-up work: **"**we have discovered significant levels of non-compliance in the firms which we have targeted for visits on the basis of a risk assessment (not a profession-wide survey). More analysis of the effects of this non-compliance will be undertaken." However, there was little evidence of enforcement activity being undertaken. Indeed, rather than taking action against solicitors found to be breaching the Rules the paper suggested action being taken against introducers -

> "We are undertaking a mailing to introducers and their regulators in which we advise them of the rules to which solicitors are subject. We warn that if an introducer persists in leading solicitors to breach the regulatory requirements, the SRA will consider "naming and shaming" the introducer, and warn solicitors against accepting referrals from that source."

10. This is an indictment of the process. It is saying that the SRA is unable to enforce its own rules and instead is proposing to "name and shame" introducers.

11. The SRA must develop proposals that will enable action to be taken more quickly and effectively against solicitors who do not comply with the rules. While the legal

framework may well be unsatisfactory it should be possible to devise a satisfactory workaround. If this is not done the regulation of solicitors will continue to be ineffective.

Passporting

12. Para 3.9 proposes that all existing practices will be "passported" into the new arrangements, that is they will automatically be authorised and not be required to provide any information. This practice, more commonly known as "grandfathering", was used in the financial services industry with unsatisfactory results, and has subsequently been abandoned. It is at the point of application when the regulator has most power and is best in a position is set out his store and to use a system which helps force compliance. The Claims Management Regulator did this with good effect (an analysis is available). The SRA should avoid the easy option and instead require all firms to seek authorisation. The application process should require practices to self-certify that they comply with SRA rules and also other basic legal requirements, for example those governing information on websites.

Detailed points

13. The paper refers to the involvement of non-lawyer "managers" in LDPs although this term is subsequently defined in para 3.7 as "partners, members or directors". This wording is misleading. A director, a member and a partner are not managers. The correct reference should be to partners, investors and directors.

14. The SRA should consider using an online application system only, as this reduces the scope for incomplete or inaccurate application forms.

Answers to consultation questions

The SRA has asked for comments on a number of specific points. These are not necessarily the major issues. The specific points and a short response to each are -

1. The proposed timescale for the introduction of LDPs (15 – 18 months to introduce the new regulatory regime).

This seems rather long bearing in mind that the current basic structure is remaining.

2. Design principles.

These are satisfactory.

3. "Fit and proper" test for non-lawyers, and whether there should be any requirements for other authorised persons.

This is appropriate but should be no more onerous than that applying to solicitors.

4. Moving to an annual process for all recognised bodies.

An annual process is appropriate and should not be onerous.

5. Moving to an individual process for the issue of practising certificates

This is appropriate.

6. Apportionment of regulatory costs between firms and individuals.

The proposals are sensible.

The respondent

Mark Boleat has been Director General of the Building Societies Association, the Council of Mortgage Lenders and the Association of British Insurers, and Executive Chairman of the Council of Property Search Organisations and the Association of Labour Providers. On the other side of the fence, from August 2006 to August 2007, he was Head of Regulation at the Ministry of Justice with responsibility for helping to establish and for implementing the regulatory regime for claims management businesses under the Compensation Act 2006. He is a member of the Gibraltar Financial Services Commission and was Chairman of the Retail Motor Industry Code of Practice Scrutiny Committee. In the commercial sector he is currently a Director of the St Paul Travelers Insurance Company and he has been a director of two listed companies and three life insurance companies. He is also a member of the Court of Common Council of the City of London (where he is Deputy Chairman of the Markets Committee and a member of the Policy and Resources, Police and Planning and Transportation Committees), Chairman of Hillingdon Community Trust, a Director of the City of London Citizens Advice Bureau and Deputy Chairman of the Board of the Association of Charitable Foundations. He also runs a consultancy business specialising in the handling of public policy issues.