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Dear Antony,

In my letter of 28 January about ABS authorisation, I said that we would be writing separately about the Separate Business Rule.

When deciding to recommend designation of the SRA (via the Law Society) as a licensing authority the LSB was reassured that, despite its reluctance to accept the separate business rule (SBR) as compatible with the regulatory objectives and the better regulation principles, the SRA's commitment to a review of it was an important step forwards. Our correspondence (our letter of 11 November 2011 and your reply of 27 January 2012) committed the SRA to a report on the SBR being produced by May 2012. While I understand that you have had other issues, in particular related to the PCF and IT, over the last year, we consider that the time has now come to agree the scope and timing of that review.

At present your website contains the following as a public replication of your commitment to the LSB.

> *The SRA will keep the content and operation of the waiver policy under review throughout the OFR implementation process. In addition, we will review the application of the waiver policy to the separate business provisions in the Code as part of a future review of those provisions. The timing of this review will be agreed with the LSB, taking account of broader policy developments in relation to reserved and non-reserved activities.*

We made clear in our recent document on the regulation of special bodies that the LSB did not accept the SRA's suggestion that any review of the SBR should be solely or mainly dependent on decisions on the wider special bodies/non-commercial bodies framework or the outcome of consideration by the LSB of whether general legal advice should be reserved was unacceptable, given the immediate problems which the existence of a blanket rule appears to be causing in the market at the moment.

Our starting point is that we do not expect to see all legal activities (even for only individual consumers) coming under the regulatory framework that we have. We do not see that such an approach can be compatible with our organisations' obligations under section 3 of the Legal Services Act 2007 (LSA) in relation to proportionality: we are yet to see evidence of consumer detriment that would warrant such wholesale regulation by reservation under the Legal Services Act. That conclusion may, of course, change as we undertake work on general legal advice, but, having completed our investigation into will writing, estate administration and probate, we are unconvinced that a blanket, as opposed to more targeted, approach would be likely to emerge as our preferred option. Even if our Board were to take a view that there was a compelling case for a substantial extension of regulation, we expect that it would take several years to come to fruition because of the legislative hurdles in place.

It seems to us that we should therefore focus on the current regulatory architecture in order to assess the efficacy of the separate business rule against the better regulation principles and the regulatory objectives.

The interaction of the SBR with the SRA's approach to non-reserved legal activities is perhaps at the heart of the problem. We struggle in particular to understand why a business that has successfully delivered legal advice outside of legal regulation without any evidence of consumer detriment should be compelled to bring those services within the oversight of the SRA in order to deliver reserved legal activities.

It seems that using the term MDP is misleading – these are simply licensable bodies that may well be doing any number of other activities alongside the delivery of reserved legal services. To create a class of body, or a sub-group of ABS, known as MDPs runs the risk of narrowing the effective definition of ABS to simply a law firm with a different ownership structure. Such a narrowing would be contrary to the objectives of the LSA, as it seems to be predicated on a general assumption that mixing reserved legal services with other services (whether legal activities or not) is inherently more risky than traditional law firms or legal-only ABS. We are not aware of any evidence, whether in terms of regulatory action elsewhere, prosecutions for criminal infringement or solid survey evidence of actual confusion leading to mis-purchase of services by consumers that would support such a conclusion.

We see the issue as one that is likely to grow across the legal market. At the retail end of the business, we are concerned that the rule, combined with the approach to what you call MDPs, may create artificial boundaries within the market between firms that want to deliver non-reserved activities and those that want to deliver reserved ones: if the price of delivering reserved services is regulation of other legal services that do not need to be regulated, that adds to the costs that consumers pay, distorts competition and prevents innovation.

At the opposite end of the legal market we are aware of businesses that offer firms solutions to problems that are traditionally tackled by city law firms. Some of these are joint ventures with corporate entities and some are stand alone services. If the SBR and approach to non-reserved activities continues, it can hinder law firms' competitive response to these challenges, including slowing down the pace of response, increasing the cost and providing regulatory oversight that the competitor offer does not have. But the real potential problem is faced by corporate consumers: SMEs and larger firms will seek advice from professional services firms on business problems widely defined and should not face artificial regulatory barriers which force them to carve their issue into its different legal, financial or other components, which have to be pursued separately – and probably more slowly and expensively.

We note that you are pragmatic in your waiving of this rule in practice. Indeed with some ABS applicants you have gone as far as to help them structure their business into separate entities and then waived the SBR. While this is clearly an innovative solution to the problem, it cannot be right that general regulation rather than a response to a specific risk drives the structure of a business. Indeed, as we have commented previously, a rule that is regularly waived is unlikely to be proportionate.

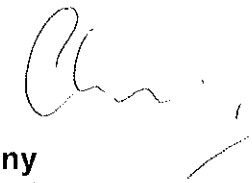
We do recognise that there may be times when a business mixing reserved and non-reserved legal services may present unacceptable risks. This is particularly so for individual consumers as opposed to corporate clients. Such examples might include consumer confusion as to who is providing a service, unacceptable standards in a closely related business that compromise consumer protection in the reserved services or deliberate or inadvertent miscommunication about the elements of regulatory protection (including access to the Ombudsman) which are available to users of an individual service. We can see the need for regulatory tools to tackle such risks on a case by case basis, which would prevent the distorting effect of the current blanket rule and frequent waivers. Our view therefore is that these risks can be managed through conditions on licences (or practice certificates and conditions for non ABS law firms) that are put in place either at authorisation or subsequently when the risks materialise. We would be happy to discuss this further with you in due course. We are not aware of any legislative obstacle, other than the current rule, that prevents such a flexible and liberal approach being put in place.

Could you please reply by the end of February setting out your plans to take this review forward during 2013. To aid our analysis of that response could you also provide us with your management information showing how many waivers have been granted for ABS and their breakdown by area of the handbook/code. Similarly, information regarding the granting of any other waivers to the SBR for non-ABS law firms is also requested. We would also like information about how many of the ABS applications that have been withdrawn had separate businesses that would have been prohibited by the SBR.

It may well be that you wish to meet before formally replying. We would be happy to arrange this.

I look forward to hearing from you.

Yours sincerely



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