

SRA response

Justice Select Committee inquiry: implications of Brexit for the justice system

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Introduction

1.

The SRA is the regulator of solicitors and law firms in England and Wales. We work to protect consumers and support the rule of law and the administration of justice. We do this by overseeing all education and training requirements necessary to practise as a solicitor, licensing individuals and firms to practise, setting the standards of the profession and regulating and enforcing compliance against these standards.

2.

This submission outlines what we believe is needed to support our vision for a modern, open legal market which, in turn, will support a competitive UK economy post-Brexit. Brexit provides an opportunity for government to reaffirm and acknowledge the importance of a diverse, strong, effective and independent legal profession providing high quality legal services internationally and to the UK commercial market, as well as to the public, and the importance of the rule of law and administration of justice underpinning our economy and international trade.

3.

It is not for us to tell firms how to manage change or how to take advantage of opportunities as they present themselves. But where we can provide support and information we do so. To this end we publish regular assessments of risks in the legal market and have recently published an initial Brexit update for the profession (Exiting the EU: An update for lawyers). Our initial analysis confirmed that there have been no changes to our current practising arrangements, nor any immediate regulatory changes as a result of the EU referendum. It is the first in what is likely to be a series of updates which will provide the profession with information and practical advice.

4.

Due to the nature of our work we have focused our response on the third strand of the terms of reference of your inquiry: the legal services sector in

England and Wales and the wider UK economy.

5.

The importance of the legal services sector to the UK economy as a whole is well known. According to TheCityUK's UK Legal Services 2016 report

[<https://www.thecityuk.com/research/uk-legal-services-2016-report/>] :

2014-15 was the fifth successive year of growth for UK-based legal services firms

the sector's trade surplus has nearly doubled over the past decade to £3.4bn in 2015

the sector's contribution to the UK economy increased to a record £25.7bn in 2015 (1.6% of GDP)

6.

The same report notes that:

the UK accounts for around 10% of the global market for legal services, second only to the US

the UK is the largest market in Europe, accounting for around a fifth of its legal services fee revenue.

7.

This latter figure reinforces figures from the Office of National Statistics on professional services as a whole, which suggest that exports to the European Union account for over half of the UK's total legal exports.

8.

As the largest regulator in legal services in England and Wales, covering around 80% of the regulated market, we oversee 168,000 solicitors worldwide and around 10,000 legal businesses who operate within this market. We also currently register European lawyers wishing to establish a permanent presence in England and Wales, and provide the regulatory information required by host regulators for English solicitors and law firms who wish to establish elsewhere in the European Union. In addition to domestic providers, we regulate English and Welsh solicitors, as well as lawyers from other jurisdictions working in partnership with solicitors, who are based in other EU countries.

9.

Due to the continuing uncertainty about the UK's future relationship with the EU, and to the wide variety of providers we regulate, it is difficult to predict



what impact Brexit will have on all those we oversee. However, we do know that the single market for services is widely used by providers in this sector, both as a market for direct exports by UK lawyers and as a base for global lawyers to serve their clients across the EU.

Impact on London as a legal centre

10.

London currently plays host to 87 of the worldwide top 100 law firms ranked by 2016 revenue. Of these, five of the top 10 global law firms are headquartered in London. There are 60 European law firms in the City, constituting around one third of all of the foreign law firms making up London's legal hub. These firms are predominantly in the City in order to service financial services clients across the EU. Their continued presence depends in turn on whether or not their clients who rely on EU single market passporting rights also remain in the UK.

11.

There are also approximately 3000 European lawyers in partnership with English solicitors in the UK and elsewhere in Europe, accounting for nearly 60% of all the partnerships English solicitors have with non-English lawyers. This provides some indication of the importance of the European market to the UK legal sector.

12.

In addition, many American law firms use their English subsidiaries (who are registered with us) as a mechanism for gaining entry to the European single market. If SRA registration no longer provides that benefit US law firms may choose an alternative centre, such as Dublin, as their entry point into the EU.

Most significant EU rights for legal services providers

13.

There are a number of rights flowing from the EU that are of high value to providers in this sector:

The right to appear before the European Courts and to legal professional privilege. These rights only accrue to lawyers holding qualifications from the European Economic Area but are very significant because they underpin all high value commercial work. The inability of UK lawyers to maintain legal privilege in the EU would mean that UK lawyers would almost certainly no



longer be instructed on high value mergers and acquisitions and similar transactions.

The right to provide English legal advice across the EU by establishing offices in all of the Member States. The loss of this right would increase the costs of using a purely English firm to clients who want advice covering a number of jurisdictions in the EU, since this advice would no longer be able to be provided seamlessly from a single firm. This would mean either increased costs of using an English firm, since local firms would also need to be instructed, or that English firms would lose such instructions.

The right of UK lawyers to fly in and fly out of European member states to provide opinions, advice and represent clients. This right will disappear from the majority of Member States in the event of the UK leaving the single market, since many Member States either do not permit foreign lawyers to practise temporarily or impose restrictive economic needs tests on the ability of non-EEA lawyers to obtain work permits.

Broader single market rights entitle UK firms to provide services elsewhere in the EU. This enables alternative business structures (ABS) from the UK to supply services either locally or from the UK. Although these rights have not yet been widely used, the expectation is that they would have become very important in the near future with the growth of online legal services. Since these rights will not be guaranteed following Brexit, the new providers of alternative and online legal services who were looking to expand within the EU, will need to do so by establishing European subsidiaries, if they can, rather than operating branch offices or as purely online providers from the UK.

Rights of legal practice painstakingly acquired through EU free trade deals will be jeopardised. In particular, UK law firms who have relied on the EU's free trade agreement with the Republic of Korea to establish in that market may lose the right to retain their office licences.

14.

The easiest 'work around' for those affected by any loss of these rights will be to hire lawyers with both UK and EU qualifications and EU nationality. Some limited rights may be protected by solicitors simply re-qualifying as lawyers in other EU member states (as over 700 English solicitors have already done in Ireland). This is not a perfect solution, however, and increases costs for those lawyers as they will be required to pay dual registration fees and possibly maintain dual insurance requirements. Further, some establishment rights may only be possible to work around by setting up subsidiary businesses in other EU countries regulated under the law of another Member State. This will not only affect English law firms but also around 45 US law firms who use their London offices as the headquarters for their EU operations and may need to move their head office location in future.

Most significant EU rights for legal services providers

15.

Consumers will also potentially be adversely impacted if the single market for legal services is undermined by Brexit. In contrast with most of the other foreign lawyers present in the UK, who tend only to practise in commercial areas, European lawyers practise across the wide spectrum of consumer and commercial law. This is a direct consequence of the degree of activity in the single market and the need for individuals to have access to legal advice in relation to property, personal injury, inheritance, tax, debt, consumer and family matters in other EU countries. UK and European citizens will therefore suffer if the single market regime for lawyers is undermined by Brexit. UK citizens with property, family and inheritance issues elsewhere in Europe, may find themselves unable to use a UK lawyer to help them deal with their problems.

16.

There are also policy consequences. When the UK leaves the European Union, the single market will lose its main advocate for a more liberal and deregulated market for legal services in the EU. The willingness of the European Commission to pursue a deregulatory agenda in the internal market for legal services has been crucial to the reforms that have been made in many other Member States in recent years – reforms that make it easier for UK law firms to operate abroad. Once the UK exits the EU it is uncertain whether the process of liberalisation will continue at the same pace, or at all, in the other Member States. However, there is still much to be done and there remain UK legal businesses that cannot yet access EU markets.

17.

Following the introduction of the Establishment Directive for lawyers in 2002, various Member States interpreted the directive in ways that were damaging to UK lawyers. The commencement, or threat of, legal action by the European Commission reversed or altered the approach being taken by Member States in many of these cases, with proceedings in the European Court of Justice only rarely being required. These actions enabled English law firms and individual lawyers to establish legal businesses in the Member States concerned, earning hundreds of millions of pounds in export revenue as a result.

18.

The UK may not have been able to uphold, let alone advance, the interests of the legal sector had the Commission and the Court of Justice not

assisted with this. The concern is therefore that a UK outside the EU:

makes enforcement more difficult, making it easier in future for Member States to undermine in practice any market access rights that have been agreed in theory

makes it less likely that EU legal markets will continue to modernise at the pace they are being encouraged to do so at the moment. Since the UK is one of the major advocates for, and prime beneficiaries of, this direction of travel there is a concern that when its voice is no longer heard at a European level, new ABS currently emerging in the UK will not be able to access the single market.

will reduce the extent to which the EU continues to press for further deregulation of the legal market due to the removal of UK lawyers and the influence of English law from the European institutions.

19.

Taking all of these various potential consequences into account, in our view, the decision to leave the European Union strengthens the case for further regulatory reform in order to support the UK in maintaining its status as a centre for legal services post Brexit.

Regulatory reform and mitigating the impact of Brexit

20.

Attractive regulatory policy could help, to some extent, to offset the disadvantages of being outside the single market. We are two years into a major programme of regulatory reform, which is focused on liberalising the market for legal services (for both business users and the public) while also maintaining appropriate protections for consumers that need them. We consider that these reforms will support the UK in maintaining its place as a global hub for legal services irrespective of the eventual settlement between the UK and the rest of the EU.

21.

Our reform process is intended to increase flexibility in law firm ownership and structure. This will make UK regulated law firm vehicles attractive to foreign investors, since they will be able to use these forms of business to raise capital for their expansion (just as in previous decades European law firms have used English LLP structures to limit their liability).

22.



Our reforms should also help to replace some of the dynamism in the UK export sector for legal services with new competitiveness in the domestic legal economy. They will enable more law firms to obtain ABS status, including law firms from outside the UK. They will encourage more capital to flow into law firms and support the provision of more technologically driven, lower cost and more accessible legal services. They will also continue to drive the development of partnerships between solicitors and other professions through MDPs, leading to more innovation in service provision.

23.

Our reform programme is designed to deliver an open, competitive domestic legal market that can provide affordable legal services. Research shows that 86% of small business think legal services are essential for running their business but only 13% think solicitors are a good value way to handle their problems. Small businesses are the backbone of the domestic economy and the big businesses of the future. Developing a legal market that meets their needs will make a significant and positive contribution to our post Brexit economy.

24.

And we know that one out of ten members of the public with a legal need do not use a regulated provider because of cost, poor access to information and uncertainty. Again, making affordable services available to this group represents a major challenge and opportunity for the legal market.

25.

Maintaining the focus on reform will help to reduce the risk that when the UK leaves the EU, its legal market becomes more parochial. This is less likely to happen if our market is a better place to do business overall for international law firms, even with reduced access to the single market.

26.

Our programme of regulatory reform has two main elements. Looking to the Future [<https://www.sra.org.uk/sra/policy/future/looking-future/>] is a phased review of our regulatory approach. This review is designed to make sure that our regulation is targeted, proportionate and fit for purpose in a fast changing and dynamic legal services market. A key part of this work is redrafting our existing Handbook and Code of Conduct to make them clearer and more concise. We are proposing two separate Codes of Conduct to clearly define the boundary between individual and entity regulation. We want to allow greater flexibility for solicitors and freedom for firms to innovate, compete and grow, and help improve access to quality services at affordable prices.

27.

Through our Training for Tomorrow [<https://www.sra.org.uk/sra/policy/solicitors-qualifying-examination/>] programme we are working to ensure tomorrow's solicitors can meet the standards expected of skilled legal professionals. As part of this we have already published a Statement of Solicitor Competence [<https://www.sra.org.uk/solicitors/competence-statement/>] , which sets out what solicitors need to be able to do to perform their role effectively and provides consumers of legal services with a clear indication of what they can expect from their solicitor. We have also introduced a new approach to ensuring that the skills and knowledge of qualified solicitors remain up to date. Our second consultation on a proposed centralised assessment - the Solicitors Qualifying Examination [<https://www.sra.org.uk/sra/consultations/consultation-listing/solicitors-qualifying-examination/>] - is currently open.

28.

A further key facet of our reform programme is intended to give solicitors more flexibility about where they can work and how they can structure their businesses, while still maintaining our stringent minimum standards. This is increasingly important to allow legal businesses to manage uncertainty. Under more flexible arrangements businesses can react rapidly to changes in the market. In comparison, prescriptive rules will either limit the adjustments business can make or slow down their ability to change (for example, by having to apply for a waiver to a rule). In order to support firms to be innovative in both their business models and the services they offer, we have established SRA Innovate [<https://www.sra.org.uk/solicitors/innovate/sra-innovate/>] . This initiative offers a 'safe space' in which firms can try new approaches with our support, and is developing a community of interest that helps to develop new thinking.

29.

Removing restrictions on the business structures solicitors can operate in will provide an added incentive to foreign law firms currently established in the City to invest further in their operations in the UK. It will allow these firms to offer English law work through solicitor partners, without needing onerous law firm authorisation, provided that these firms are not supplying legal services in areas that are more heavily regulated for reasons of public or consumer protection. This opens up new possibilities in the UK for an estimated 60-70 foreign law firms who are established here outside formal regulatory controls at present which prohibit them from offering legal services through a solicitor partner. These new avenues for business expansion will encourage foreign law firms to remain in the UK at a time

when other jurisdictions are trying to attract business from firms based in the UK.

30.

Our work will support the UK's international trade by making England and Wales the best place to based a European or global law firm. Our programme of reform is making the regulation of solicitors and firms more proportionate and targeted while also being flexible enough to allow innovative new business models to flourish. Removing unnecessary costs from businesses will enable them to compete more effectively with both UK and international providers. This is imperative as the UK and its businesses start to forge new relationships with international partners.

31.

As part of that, we are working with legal regulators across the world to develop consistent systems, approaches and principles. That supports the UK appetite to establish trading links and business to business legal sector relationships outside the EU.

32.

Even with the uncertainty surrounding future access to the single market, these changes will allow us to support London in remaining the centre of choice for European legal services. There is an ongoing need for an open, healthy competitive legal sector to support the growth of our international and domestic commercial markets. Continuing to modernise the regulation of legal services can only serve that need.