Solicitors Regulation Authority

SRA response

Transparency and Trust: Enhancing the transparency of UK company ownership and increasing trust in UK business

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Read consultation paper Transparency and trust: enhancing the transparency of UK company ownership and increasing trust in UK business [https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/212079/bis-13-959-transparency-and-trust-enhancing-the-transparency-of-uk-company-ownership-and-increaing-trust-in-uk-business.pdf] .

Introduction

This response is submitted on behalf of the Solicitors Regulation Authority (SRA), the independent regulatory body of the Law Society for England and Wales (TLS). We regulate individual solicitors and their firms, other lawyers and non lawyers with whom they practise, and other organisations providing legal services to consumers in England and Wales.

We welcome the opportunity to take part in this consultation and set out our comments below. Where we have not made comment in response to a specific issue or question, we remain neutral on issues/proposals discussed.

We note that the proposals are aimed at addressing opaque company ownership structures and improving the accountability of company directors. We hope that the proposals will aide confidence in the UK as an open and trusted place to invest and do business.

We are pleased to note that proposals are consistent with the principles and outcomes which apply to our regulated community and we are confident that our modern, outcomes-focused, risk-based approach to authorisation, supervision and effective enforcement will benefit the public interest including consumers interests.

The SRA

The SRA is the independent regulatory body established by the Law Society for the regulation of legal services provided by law firms and solicitors in England & Wales. The SRA's powers arise from various statutes and regulations including the Solicitors Act 1974, the

Administration of Justice Act 1985, the Courts and Legal Services Act 1990, the Legal Services Act 2007 and the SRA's Handbook.

The provisions of the SRA Handbook came into force on 6 October 2011. The core regulatory requirements in the Handbook are the 10 principles, compliance with which is mandatory.

Since October 2011, the SRA has adopted a risk-based outcomes-focused approach to regulation. This is a regulatory regime that focuses on the high level principles and outcomes which drives the provision of services to clients and promotes the effective management of a solicitors business. This approach allows for the SRA to focus on issues which really matter and fosters an environment where practitioners are required to take responsibility for managing risks in particular contexts whilst allowing flexibility in how they deliver services to their clients.

Those regulated by the SRA are in a period of significant change. Much of this is driven by those individuals and firms themselves, as they seek to improve quality and service standards, develop new markets and new ways of working and greater competitiveness.

The SRA regulates in the public interest and is determined to ensure that the public are able to access safe, ethical, good quality legal services that meet their needs. The SRA shares those core principles with the great majority of those we regulate. However, given the rapidly evolving nature of the legal services market, how the SRA regulates and what the SRA focuses its resources on at any point in time must, and will, continually change.

The SRAs key objectives and the programme of work, both in developing its regulatory approach and in the delivery of regulation, are framed and influenced by two underlying factors (as well as by the analysis of the SRAs current environment):

- the SRAs regulatory objectives and principles derived from the statutory and regulatory framework within which the SRA carries out its role; and
- the vision and values to which the organisation, and the people who work within it, are committed.

The current legal services market

Today's expanding legal services market is in a state of rapid development and transition, triggered by regulatory and other developments, primarily as a result of the Legal Services Act 2007 (LSA) which set out eight regulatory objectives in respect of the supply of legal services as follows:

- protecting and promoting the public interest;

- supporting the constitutional principle of the rule of law;
- improving access to justice;
- protecting and improving the interests of consumers;
- promoting competition in the provision of services;
- encouraging an independent, strong, diverse and effective legal profession;
- increasing public understanding of the citizen's legal rights and duties;
- promoting and maintaining adherence to the professional principles set out.

The LSA was passed with the intention of liberalising the legal services market by, for example, allowing Alternative Business Structures (ABS) and encouraging innovative new models for the provision of legal services. The continuing advances in technology; globalisation; demographic and social changes; demands for better value for money and the rise of consumerism have all led to altered expectations of what is required from providers of legal services.

The SRAs regulated community

The SRA's purpose is to protect the public by ensuring that all individuals we regulate meet high standards and taking action when we identify risks to the public. The SRA regulates firms and, since December 2011, bodies licensed under the LSA as well as the individuals employed within those entities, in the public interest.

The SRA authorises individuals and firms including all those providing reserved legal activities as defined by the LSA, excluding notarial activities. The SRA is the largest of the approved regulators in England and Wales. The SRA regulates 128,169 practising solicitors, 4,653 other lawyers and 10,827 entities and their employees and managers[1]. The total number of solicitors on the roll (the record of individuals who are qualified, but not necessarily practising or practising with a statutory exemption) at the end of February 2013 was 164,998.

The SRA distinguishes over fifty areas of law or legal practice in which the regulated persons are most active. The SRA Principles and the SRA Code of Conduct requires all to provide a good standard of service to their clients, and to exercise competence, skill and diligence.

Regulated individuals

The SRA regulates Solicitors, Registered European lawyers (RELs) and Registered Foreign Lawyers (RFLs).

Regulated firms

The SRA regulates bodies which have authorised by the SRA to practise as a licensed body or a recognised body. These can range from sole practitioners to huge firms with a global presence and thousands of lawyers. The SRA regulates the managers, owners and employees of the firms we regulate, even if those individuals are not themselves lawyers.

The Law Society's sector analysis2 distinguishes the top 200 firms regulated by the SRA by turnover as 'large firms'. These firms constitute just under 2% of all SRA regulated entities and generate fee income upwards of £11.5million per annum. Large firms employ over two-fifths of all solicitors in private practice and generate two-thirds of total fee income. Nearly half of the income generated in England & Wales by large firms comes from business and commercial work for listed and non-listed companies. However, there is a great variety in the specialism of this group, which includes some of the leading personal injury firms and some that provide private client services to 'retail' consumers and High Net Worth Private Individuals' (HNWPI), including wills and probate, tax and trusts.

At the remaining 98% of firms ('small and medium' sized firms) work from private individuals accounted for approximately 50% of total turnover and 56% of their client base in 2011. Small and medium firms dominate in the provision of the most common 'retail' services: conveyancing, family, probate, wills, personal injury, immigration, employment and crime.

1 SRA Regulated population statistics [https://www.sra.org.uk/sra/how-we-work/archive/reports/statistics/regulated-community-statistics/] , accessed 22 March 2013.

2 Law Society Report – The Legal Services Industry Part 2 – Main Sectors

The proposals

By enhancing the "transparency of company ownership", we note the proposals seek to:

1. Prevent illegal activity,
2. Better enable companies to be held to account; and
3. Provide businesses, investors, employees and consumers with confidence that companies are acting fairly.

These are initiatives which we fully support.

Beneficial ownership and a central registry

We note that the proposals refer to the introduction of a new central registry of the beneficial owners of all UK incorporated companies is held by Companies House, which we fully support. It is not, however, clear from the

discussion paper whether this is to be updated periodically or as the owners change. We note that the requirement will apply to anyone who holds more than 25% of the shares or voting rights of a company (taken in conjunction with anyone acting in concert with them). We note the proposal which sets out the intention to simplify the filings of annual returns and the suggestion of combining them with the annual accounts filed by companies.

We support the proposed definition of beneficial ownership however, with regards to its application we would refer the department to Schedule 13 of the Legal Services Act 2007 (LSA) which considers ownership of licensed bodies. Since January 2012, the SRA has been approved as a licensing authority for licensed bodies, commonly known ABSs. An ABS is a regulated organisation which provides legal services and has some form of non-lawyer involvement. This involvement can either be at the management level e.g. as a partner, director or member; or as an owner e.g. an investor or shareholder.

Compared to a traditional law firm, ABS are more flexible, in that

- lawyers and non-lawyers can share the management and control of businesses,
- ABS can have external investment and ownership,
- an ABS can offer multiple services to clients (including legal services) from within the same entity (known as a multidisciplinary practice).

To become licensed as an ABS, applicants must meet standards and requirements set out in the SRA Handbook. Our emphasis in considering applications for licences is on ensuring that investors with a material interest and managers satisfy the SRA Suitability Test and that all entities applying for authorisation meet our criteria for authorisation.

Non-lawyer owners with a 10% interest (or significant influence over) in an ABS will need to demonstrate their fitness and propriety. The SRA has published its suitability test. Many requirements reflect those placed upon solicitors entering the profession. However, there are additional requirements relating to financial status and corporate behaviour.

Solicitors will normally be deemed to be fit to manage a firm, however, other managers will need to demonstrate their suitability. The SRA applies the same test to managers as to owners.

Under the LSA the SRA must approve the holding of a "material interest" by a "non-lawyer" in an ABS, as well as authorise the firm as a whole as being appropriate to provide legal services.

In order to assess whether a "non-lawyer" has a material interest in an ABS and therefore requires specific notification to and approval by the SRA

under Schedule 13, the LSA distinguishes between:

authorised persons – essentially "lawyers" and law firms, including solicitors, registered European lawyers, SRA-regulated law firms, barristers, licensed conveyancers and legal executives; and

non-authorised persons – essentially any individual (or entity, such as a company) who is not one of the following:

a) an authorised person (see the summary above);

b) a registered foreign lawyer;

c) a member of an Establishment Directive profession entitled to pursue professional activities in an Establishment Directive state (more information on the Establishment Directive); or

d) a firm providing legal services in which all of the managers (the term "managers" generally refers to partners in a partnership, members of an LLP or directors of a company) and owners are individuals within (a)-(c) above or are bodies in which more than 90 per cent of the managers and owners are within (a)-(c) above.

The definitions of "authorised" and "non-authorised" persons are technical. For the purposes of understanding when SRA approval will be required of a material interest held by a person (whether it be an individual or an entity such as a company), it may assist to think of "authorised persons" simply as lawyers and "non-authorised persons" as non-lawyers.

We have in our guidance provided simple examples of when a non-authorised person would hold an interest in a law firm are as follows:

- nine solicitors and one marketing specialist with no legal qualifications wish to work in partnership together as a law firm;
- a law firm which is a private limited company wishes to sell some of its shares to another limited company which is not a itself a law firm and has no lawyers involved in the company (there are circumstances where a firm has lawyers involved in it who are not practising and are therefore, treated as a "non authorised" persons).

In these scenarios the law firm would need to apply to become an ABS but, under Schedule 13 to the LSA, if the interest which the non-authorised person will hold in the ABS is of such a size or nature so as to make it "material" then:

- there will be a legal obligation to notify the SRA of the proposed holding of a material interest and a criminal offence may be committed if this is not done;

- the holding of that ownership interest (whether it be shares in a limited company or a non-lawyer being a partner in a partnership for example) by the person in question will need to be approved by the SRA;
- the SRA may refuse to approve the ownership interest or impose conditions upon the holding of that ownership interest;
- the SRA may withdraw approval of the holding of the ownership interest or impose conditions at a later date; and
- the SRA may take action to enforce conditions or remove the material interest from a person in certain circumstances.

If the ownership interest held by the non-authorised person is not of such a size or nature so as to be "material" however, then the we will simply consider the ownership of the firm as part of its broader assessment of the suitability of an ABS to provide legal services.

We consider that the proposal be amended and the 25% threshold be amended through the negotiation of the EU Money Laundering Directive so that it is consistent with the Legal Services Act 2007. We do however, agree with the suggestion that the scope of the registry should be extended as this will allow for further transparency and where necessary allow law enforcement and regulatory authorities to review who entities have evolved and where links may exist between different entities, including those which would not normally fall within the requirement to provide details to Companies House or the Financial Conduct Authority.

We hope that companies will support the proposal to identify their beneficial owners, and agree that if shares are held on express trusts, that the trustees should be disclosed as the beneficial owner and has asked whether the beneficiaries should also be disclosed.

We feel that such a register would ease the our task of identifying ultimate owners of alternative business structures and of identifying risks in complex structures, reducing the probability of the identified risks, discussed in the paper, crystallising. We agree that Part 22 of the Companies Act 2006 is extended to include reference to private companies and agree with the additional requirements which are need to support the proposal. However, we refer the department to earlier comments made with reference to schedule 13 of the Legal Services Act 2007.

Trusts

We support the proposal requiring the trustee(s) of express trusts to be disclosed as the beneficial owner of a company and that this be extended to beneficiaries of a trust. There may be circumstances where either a trustee and/or beneficiary have been subject to regulatory findings in a professional capacity or where the individual is know to have links to

interest or political organisations which may make it undesirable for them to have control or a material interest in a regulated entity.

Supporting investigations

We fully support the proposal and hope that the memorandums of understanding we have in place with various organisations will aide proactive sharing of information so as to aid the effective regulation and investigation.

The Central Registry

We agree that the requirements which apply in respect of a company's legal owners should be mirrored with regards to declaring beneficial ownership. However, we consider that companies should make disclosure of all beneficial owners rather than just those with over a 25% interest. Furthermore, our experience has show that beneficial ownership does not always map to individual shares. Through this process we consider it appropriate for companies to be reminded that it is not only the requirements of Companies House which matter and do not realise the importance of maintaining an up-to-date record of shareholders and beneficiaries. This situation can be addressed by amending the Companies House requirements to bring them in line with the Company's obligations.

In order to support the accuracy of information held on the central register, we would suggest that all information to be verified by the Company and its personnel certifying that they have carried out relevant checks in respect of the information being provided. That may also include companies having information affirmed through an independent certification process.

We also consider it appropriate for beneficial ownership information to be updated as the information changes and this includes beneficial owners themselves proactively informing the company of any change. For the SRA, it is imperative that our records about all entities we authorise is accurate as this impacts on potential investigations and enforcement action. Furthermore, the SRA authorisation and practice framework rules and related regulatory requirements require prompt notification of a change in ownership and/or managers - we consider that any change or proposal suggested by the department should consider the potential impact on other organisations which rely on company information.

We support the proposal that the registry be made public - this will, in our view, promote transparency and competition. If beneficial ownership information is however, not made available then we propose that it be made available to all law enforcements agencies, legal and financial regulators and tax authorities. The provision of such information needs to be supported through an enhanced disclosure process so to avoid any regulatory decision being made on out of date information or which was not

in the public interest. The department would have to consider safeguards to ensure the protection of confidential information and any price sensitive information.

The impact of reform

We consider that the benefits of the reforms proposed significantly outweigh any negative impact. The reforms promote trust and transparency but also promotes the notion that UK companies are easy to do business with which will promote competition and investment. We consider that positive compliance will promote an environment which supports businesses and will allow for growth and innovation.

We repeat that the proposals will support the identification of the ultimate owners of alternative business structures and early identification of risks in complex structures, reducing the probability of the identified risks crystallising which will inevitably result in enforcement action and mistrust amongst the wider public.

Bearer shares

We agree with the proposal prohibiting the issue of new bearer shares and that a reasonable period of time be given for existing bearer shares to convert to ordinary shares. This time will allow bearer shares to consider the impact of the proposal and seek advice and also allow them to consider their continued involvement in companies. We consider that the proposal supports the need for transparency and will limit the scope for any fraudulent activity or foreign investment from politically exposed persons or groups.

Nominee shares

The discussion suggests that nominee directors are breaching their statutory duties, however, enforcement action can be difficult as Companies House holds no data on the number of nominee directors. We therefore, support the need for increased transparency and the recommendations made by FATF. We also agree that the nominee director should provide details of the beneficial owner on whose behalf they have been appointed to Companies House. It is improper for nominee directors to be appointed where there purpose is solely to conceal the identity of others involved controlling the actual business.

We consider that the benefits discussed in the paper clearly outweigh the costs however, the department will need to consider developing a framework whereby certain protections remain where they are needed and in the public interest.

Corporate directors

We agree that the corporate director structure is open to misuse and are used in an attempt to avoid personal liability and can in certain circumstances lead to unnecessary and inappropriate information gaps. Because of the issues identified by the department, we consider that before any decisions are made and proposals agreed further research needs to be carried out to fully understand the risks and also the number of potential structures which operate in such a way.

Increasing trust in UK business

The proposals discussed suggest amending the statutory duties of directors in key sectors, who would be obliged to prioritise financial stability over the interests of company shareholders. It is suggested that that powers be given to disqualify directors from certain sectors. This proposal is fully supported as in certain cases it is clearly evident that it would be inappropriate for individuals to hold appointments.

We note that it is proposed that courts be able to consider more factors when deciding whether a director should be disqualified. They may also be given new powers to order directors to undertake training so that they are better able to manage companies when their ban comes to an end.

The proposals discussed are aligned to our current approach to regulation and supports the discussions we have had with regards to developing our financial stability programme which looks at the accountability of individuals in firms and the control of directors where needed through regulatory arrangements and conditions on practise. We agree that directors should be more accountable for misconduct or company failure. In the financial and legal sector we have seen examples of where the impact of misconduct can be highly destructive to both the economy and wider society duties. In certain circumstances, it will be appropriate for disqualified directors to directly compensate creditors after a company fails, or be offered training which, if undertaken, could reduce the length of any disqualification - these are proposals which we support and agree will enhance the trust placed in those who hold such appointments.

Lessons learnt should emphasise the need for directors of businesses to accept their broader public duties, prioritising the safety of the system within which they operate as a whole over that of profit generation and unsustainable objectives.

The discussion paper acknowledges that businesses will inevitably take risks. Risk-taking is an unavoidable part of constructing a business and we support those with foresight and passion to have the courage of their convictions. However, risk-foresight should not excuse anyone who recklessly chooses to put at stake the interests of consumers over proper risk governance and control. It is in these cases that consumers suffer and

find themselves in an unpalatable position with no or limited rights of redress.

Financial redress

We agree that it is important to consider appropriate mechanisms to increase trust in any regime by ensuring that if directors (and those advising them) act fraudulently or recklessly they personally run the risk of being required to compensate those suffering loss as a result. We support the objectives which will:

- Increase the prospects of culpable directors being pursued where they have been responsible for allowing companies to trade wrongfully or fraudulently, by allowing a liquidator to sell or assign a civil action to a third party; and
- Explore new ways by which culpable directors may be called to account, by giving the courts powers to make compensatory awards at the time they make a disqualification order.

Time limit for disqualification proceedings

In all cases, it is desirable that the conduct of directors is considered. It is acknowledged that in a minority of cases where the information regarding unfit conduct does not come to light until a very late stage or where the case is exceptionally large, complex or time consuming, the time limit might pose a barrier to disqualification action. We agree that an extension of time (5 years) would be appropriate to ensure all cases of improper conduct are addressed.

Educating directors

The importance of continued professional development for ensuring ongoing competence highlights the need to create schemes that are effective at supporting useful learning and reflection, and which provide appropriate quality assurance. We therefore, agree that training for all directors could be used to promote trust and confidence in the market by seeking to influence or address behaviours exhibited by unfit directors.

The department may be aware of the Legal Education and Training Review (LETR), which is a joint project of the Solicitors Regulation Authority (SRA), the Bar Standards Board (BSB) and ILEX Professional Standards (IPS). It constitutes a fundamental, evidence-based review of education and training requirements across regulated and non-regulated legal services in England and Wales. LETR echoes the need for adequate professional training and continued development and proposes a range of incremental but collectively significant reforms. Key recommendations of the review will:

- strengthen requirements for education and training in legal ethics, values and professionalism, the development of management skills, communication skills, and equality and diversity;
- enhance consistency of education and training through a more robust system of learning outcomes and standards, and increased standardisation of assessment;
- place greater emphasis on assuring the continuing competence of legal service providers through a system of continuing professional development that will require practitioners more actively to plan and demonstrate the value of continuing learning.

We will be pleased to discuss with the department our emerging thinking as we implement LETR and strengthen our CPD requirements.

Overseas restrictions

We support the need to recognise overseas disqualifications and the proposals which will provide for a foreign restriction to apply in the UK automatically or, alternatively, only after an application has been made to a court here for a finding of unfitness. This again ensures that only those suitable hold the position of director. We agree also that the Secretary of State should have the power to bring disqualification proceedings against a person who has been convicted of a criminal offence overseas in connection with management of a company or business overseas.

We welcome the opportunity to work with the department as these proposals are developed and this in itself will provide for a consistent approach to regulation where needed and in the public interest.