SRA BOARD
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Overseas Accounts Requirements

Purpose

1. To seek the Board's agreement to changes to the accounting requirements for SRA regulated firms and individuals practising overseas and their overseas practices, and for European Exempt Practices established in England and Wales.

Recommendations

2. The Board is asked to:

    a) note the summary of the outcome of our consultation on changes to overseas accounts requirements (paragraphs 7 and 8 and Annex 1);

    b) make the SRA Amendments to the Overseas Rules [2015] under Rule 3 of the SRA Amendment to Regulatory Arrangements (Accountant's Reports and Overseas Rues) Rules 2015 to come into effect on 1 November 2015, subject to the approval of the Legal Services Board (paragraphs 9 to 23 and Annex 2 of paper 10(i));

    c) make the SRA Amendments to Part 7 of the Accounts Rules under Rule 2 of the SRA Amendment to Regulatory Arrangements (Accountant's Reports and Overseas Rues) Rules 2015 to come into effect on 1 November 2015, subject to the approval of the Legal Services Board (paragraph 25 and Annex 2 of paper 10(i)).

If you have any questions about this paper please contact Crispin Passmore, Executive Director, Regulation and Education, crispin.passmore@sra.org.uk or 0121 329 6633.

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Overseas Accounts Requirements

Background

3. As part of its package of simplification measures and in response to representations from firms with significant overseas operations, we consulted in September 2014 on a package of changes to the accounts rules that apply to authorised persons practising overseas and to overseas practices[1].

4. The Board considered these proposals, in principle, at its meeting on 11th March. At that time, further work was required in order to develop detailed rules to implement the proposals, and to align development of new accountants reporting requirements with the domestic policy in this area. This paper brings the issues back before the Board following completion of this further work.

What rules currently apply?

5. Solicitors of England and Wales frequently establish themselves in other jurisdictions, either on an individual basis or in entities which may or may not be SRA authorised bodies. Specific requirements have therefore long been considered necessary in order to balance considerations of client protection and client expectations of what it means to use a solicitor of England and Wales, with the recognition that solicitors based overseas may be subject to local accounts requirements, or work in entities that are majority owned by local lawyers. The requirements currently in place therefore seek to ensure similar protection for client money held overseas to those which apply in a domestic context but by way of rules which are more adaptable to conditions in other jurisdictions.

6. At present, the accounts rules which apply to overseas practice are contained within a distinct section of the SRA Accounts Rules 2011 (SAR) (Part 7). This covers four issues: the payment of interest (rule 49); the holding and treatment of client money (rule 50.3); the preparation and submission of accountants' reports (rules 50.4-50.6); and the production of information at the SRA's request (rule 51). Each rule is prefaced with different application rules and the glossary definitions employed (e.g. for *client money (overseas)*) are significantly different to those used for domestic purposes. This was recently amended, in April 2015, to include Registered European Lawyers (RELs) practising from an office in England and Wales of an Exempt European Practices (EEPs), which are bodies not authorised by the SRA. This change was intended to

[1] An 'overseas practice' is any entity outside England and Wales which is under the de facto or de jure control of an SRA authorised body, as defined in the glossary.

ensure that the SRA could hold individual RELs to account for their handling of client money through proportionate rules.

A consultation on proposed changes

7. Between 30 September and 22 December 2014 we held a consultation seeking views on proposals to modify the rules in relation to overseas accounts. In summary, the proposals sought to ensure that the overseas accounts rules were clearer and more accessible and applied more consistently to firms and individuals with overseas practices This was done to ensure the reporting requirements were proportionate and targeted, with the aim of reducing unnecessary costs for legal services providers.

8. We only had 6 responses to our consultation, reflecting the fact that those who are most affected by them are the large international firms, whose views were represented in the response of the City of London Law Society. One international firm and the London office of one US firm made separate responses. Other responses were received from one of the big five accounting firms, the Junior Lawyers Division and the Law Society.

Recommendation: the Board is asked to note the summary of the outcome of our consultation on changes to overseas accounts requirements (Annex 1).

Summary of the consultation proposals

Moving the overseas accounts rules in to the SRA Overseas Rules

9. The consultation proposed moving the overseas accounts provisions into the overseas rules, in order to simplify their application. This was in order to make these more accessible for those to whom they apply, placing all of the regulatory requirements relating to overseas practice in one set of rules.

10. Further, the proposal aimed to amend the application of the rules, which currently depends on the rule in question and is defined by reference to practice structure. The proposal would have the effect of bringing all overseas practices and individuals practicing overseas within the application of the overseas accounts rules, irrespective of the mechanism through which they do so.

11. The majority of those respondents who expressed a view agreed with our proposal to move the accounts rules in relation to overseas practice into the Overseas Rules. Three of the respondents highlighted the fact that reference to the domestic rules and/or the the guidance to them, might be facilitated if they remained together. A number of other respondents, however, argued the benefits of a clearer separation between overseas and domestic accounts rules, and we consider that these include the fact that this would

avoid the application of inappropriately detailed domestic rules in an international environment.

12. All respondents who expressed a view agreed that the current application of the overseas accounts rules required reform. As one respondent, the large accounting firm, stated, 'The current application does not always appear to be clear and does confuse many law firms. In addition, it can result in law firms falling in and out of scope of the Overseas Rules between one year and the next.'

13. The City of London Law Society (CLLS) also highlighted the difficulties with the current arrangements, stating that 'Under the current application provisions in part 7 of the SRA Accounts Rules 2011 whether or not the overseas accounts provisions apply is highly sensitive to, and dependent on, the legal structure of the firm in question. The scope of application has thus been inconsistent within firms and as between different firms, leaving gaps in regulation. The application of the new overseas accounts rules as set out in the consultation delivers a consistency irrespective of any given firm's structure, and so better protects the solicitor brand.' The Law Society agreed, confirming that the proposal will 'allow the SRA to apply the rules more consistently and will be easier for firms to understand.'

Revised rules

14. The consultation also asked for comments on a new simplified draft of the applicable rules (new overseas rule 5.1), couched in terms of principles and therefore easier to apply across multiple jurisdictions. There was consensus that the new approach was simpler and clearer: The CLLS supported this, stating 'The proposed new rules contain all of the substantive obligations in rule 50.3 of the current SRA Accounts Rules, but allow practitioners discretion and flexibility in how they achieve compliance. This approach is less likely to give rise to conflict with local law or regulation whilst continuing to offer adequate protection to clients.' One firm also welcomed the fact that this provided firms with latitude.

15. We received a few detailed comments on the content of the new rule. These related to matters such as the treatment of interest and unclaimed client balances. These detailed comments have all been taken on board in the amended draft attached at Annex 2 of paper 6(c)(i). We did not however include a definition of the term 'without undue delay', as suggested by CLLS as we believe that this should be given its natural meaning: By way of clarification, the word 'undue' was introduced to add a margin of flexibility into the time required to reconcile monies received from different time zones, where this can be justified. There was consensus amongst the respondents that our new definition of client money (overseas) was confusing and required further work. We have carefully considered the comments and drafting suggestions provided, in developing our further draft for the Board's consideration.

Accountants' reports

16. There were mixed views on our proposal to remove the standing requirement for accountants' reports in relation to overseas practices holding client money. The international firms responding and the CLLS strongly supported the proposal to integrate reporting on overseas accounts into reporting on overseas practices. However, there were views expressed that reporting requirements increased client confidence (from a solicitor's firm) and that overseas practices were more 'risky' (from an accountancy firm). A number of those objecting to the proposed approach referred to the fact that this was different to the approach proposed for domestic client accounts, suggesting that reports should be obtained but could be submitted only if qualified.

17. In considering these concerns, we took into account the evidence from accountants' reports from overseas practices which we have received over the past five years and the fact that the rules governing accounts overseas will now be embedded in the overseas rules which has its own reporting obligations. The results of our review are set out below.

Review of Accountants' reports

18. At present, there are only 513 offices overseas that are captured by application of the existing Part 7 SAR. In the last five years (2010-2015), only 158 (30%) of these offices have submitted separate accountants reports, illustrating that in many countries, handling of client money is not permitted, and that firms often choose to centralise their handling of client monies in the UK, or in a few jurisdictions which can be risk managed more effectively. The 158 offices which submitted accountantse last five years (2010-2015)5 authorised bodies in England and Wales, all of which are international firms with multiple offices in different jurisdictions and the vast majority of which are under our Regulatory Management team.

19. Only 72 (45%) of those offices which submitted reports did so in each of the five years examined but there was no discernible correlation between the frequency of reporting and the number of qualified reports. Accountants' reports received from overseas offices were qualified in 188 cases (33% of the total submitted). The jurisdictional pattern which emerged, illustrated that in cases where local accounts rules had derived from English rules in the past (e.g. Hong Kong and Singapore), the level of qualified reports was about 20% of the total, the average in other jurisdictions was around 30% with the exception of France (73%), Spain (60%) and Scotland (50%). This suggests that the reports that we receive from overseas jurisdictions are more likely to be qualified in jurisdictions in which the rules relating to the handling of client money are less aligned with the SRA's rules.

20. Of the 45 firms who submitted reports in relation to their overseas offices, there was insufficient evidence to establish whether any systemic issues existed and no evidence of any SDT action taken against firms in relation to breaches of accounts rules overseas.

21. We have noted that our reporting requirements can duplicate local regulatory requirements, as reflected in the response from CLLS. Further, we have noted that the majority of respondents consider that if the mandatory requirements are removed, firms are likely to continue to conduct some form of external audit, for their own risk management purposes. The CLLS stated that 'It is nevertheless the view of many City firms that the blanket application to all overseas offices, irrespective of the volume of transactional activity, nature of the transactions, and amount of money held, is disproportionate to the risk.'

22. Our review into the value of the reports which are currently received by us, when set against the cost to the firms of producing them and to us of handling them, has led us to propose an amendment to our current requirements. In future, we propose that we should be able to request reports but will not expect to receive them automatically. This is a more proportionate approach since as far as overseas practices are concerned, the we are most likely to have our interest in any particular firm piqued by evidence emerging from the authorised body in England and Wales which is responsible for an overseas practice, or by information passed to it from that source.

23. For these reasons, we believe that our proposed approach of using the reporting requirements under the Overseas Rules would appear to us to be the most appropriate mechanism for ensuring ongoing client protection: This removes a blanket requirement to obtain a report, but allows us to require this on a case by case basis. We are likely to do so in circumstances where, for example:

    - the SRA has concerns about the responsible authorised body and their handling of client money; or

    - the responsible authorised body has reported its own concerns.

24. This approach will allow us to apply a proportionate and risk based approach, placing more responsibility on SRA authorised bodies with overseas practices, regardless of whether these are subsidiaries or branches. We believe that this represents a proportionate and risk-based approach, consistent with the thrust of the SRA Overseas Rules, which create accountability for the actions of overseas practices through the obligations that apply to the 'parent' SRA authorised body and the regulated individual practising overseas. Both the responsible authorised body and the regulated individual are required under the Overseas Rules to report material and systemic breaches of our requirements.

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Summary of amendments to the Overseas Rules

25. In the Overseas Rules we are proposing the following changes:

i) amendments to clarify that the new provisions in the Overseas Rules relating to client monies must be complied alongside any local regulatory requirements, and that these flow from Overseas Principle 10 (relating to client money and assets);

ii) the main body of the new rules on overseas accounts is contained in Rule 5. This sets out eight basic requirements on the handling of client money which preserve the key content of the existing rules, stripping out unnecessary detail;

iii) Rule 6 requires reporting of material or systemic breaches of the Overseas Principles to the SRA. It also allows the SRA to request an accountant's report from a responsible authorised body in respect of one (or more) of its overseas practices;

iv) a provision covering transitional arrangements for accountants' reports from overseas offices will be inserted into the amendment regulations. These transitional arrangements will require the submission of any reports that are outstanding or expected before the entry into force of the new rules, but remove the automatic reporting requirement for subsequent periods;

v) we are also proposing changes to the definitions of *client money overseas client account (overseas)* and *office money (overseas)* which bring these terms into line with domestic definitions, whilst allowing these to exist as stand-alone glossary terms and to reflect the differences in terminology and need to remove references specific to the domestic jurisdiction (for example, stamp duty land tax, Land Registry registration fees, and PAYE); and

vi) finally, as a separate tidying up exercise, we are proposing to delete the commencement provisions in the Overseas Rules as these are no longer relevant.

Recommendation: make the SRA Amendments to the Overseas Rules [2015] under Rule 3 of the SRA Amendment to Regulatory Arrangements (Accountant's Reports and Overseas Rues) Rules 2015 to come into effect on 1 November 2015, subject to the approval of the Legal Services Board.

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Changes to Part 7 (SAR): application to RELs in EEPs

26. We are proposing to introduce rules to apply in future to Registered European Lawyers (RELs) working in Exempt European Practices (EEPs) which will mirror the requirements we have in relation to solicitors practising overseas. In other words, a principled regime will apply which makes it clear that client money and assets must be protected, but which will not impose detailed requirements, since our Handbook will not apply to the bodies in which these individuals are working. The domestic provisions on obtaining and delivering accountants reports in Part 6 of the SAR will apply to RELs in EEPs who do hold client money. We consider that this approach is justified because RELs working in EEPs are established in England and Wales and subject to our code of conduct. It is therefore reasonable to apply the same approach to them as to other authorised persons, whilst reflecting that they work in entities that are outside our control.

Recommendation: make the SRA Amendments to Part 7 of the Accounts Rules under Rule 2 of the SRA Amendment to Regulatory Arrangements (Accountant's Reports and Overseas Rues) Rules 2015 to come into effect on 1 November 2015, subject to the approval of the Legal Services Board.

Solicitors Regulation Authority

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Supporting information

Links to the Strategic Plan and / or Business Plan

27. The proposals are linked to Strategic Objective two: Deliver risk-based outcomes-focused regulation so as to achieve positive outcomes for consumers in the public interest and do so in a way that is justifiable to all our stakeholders.

28. The proposed changes to Overseas Rules deliver phase two of a programme of reform which is integral to our wider objectives to ensure that regulation is proportionate and targeted, with the aim of removing unnecessary burdens, while providing appropriate levels of consumer protection.

How the issues support the principles of better regulation

29. The proposed amendments to the SRA Overseas Rules will meet these principles by removing unnecessary complexity, and achieving a more consistent and proportionate application of our accounts rules to overseas practices. Our proposed new approach for overseas practices will allow both us, and the firms concerned, to focus on significant issues, rather than time consuming procedural requirements and the need for explanations of trivial breaches. We therefore believe that this proposal represents an appropriate risk based reduction in regulatory burdens.

What engagement approach has been used to inform the work and what further communication and engagement is needed

30. We engaged with key stakeholders prior to the consultation and have carefully considered consultation responses. We have taken on board many of the suggestions made. We will incorporate additional communication on both the new Part 7 of the SRA Accounts Rules and on the Overseas Rules into our wider communications on these rules with the stakeholder groups most concerned by them.

What equality and diversity considerations relate to this issue

31. Although much overseas practice is carried out by larger firms and the current rules on reporting have only affected large international firms to date (see analysis of current accounting reports above), market intelligence suggests that there are a growing number of smaller firms looking to set up overseas offices. The new rules will provide a clearer framework for those wishing to set up overseas offices in future. It is nonetheless worth noting that the practice of most small firms with overseas offices to date has been to establish representative offices which do not hold client money.

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Consumer impact

32. It should be noted that, the vast majority of overseas business is transacted for business clients (as opposed to business for UK residents instructing England and Wales based solicitors to act for them in another jurisdiction). 1. The rule changes proposed do not reduce the protections or the principles relating to handling of client money overseas and the changes to the reporting requirements should not reduce our knowledge of whether client money overseas has been mishandled, it will simply alter the mechanism through which this happens, from a local accountant's report to a report from the responsible authorized body. Our proposals will bring greater consistency of protection for consumers by bringing all overseas practices and individuals practicing overseas within the application of the overseas accounts rules, irrespective of the mechanism through which they do so.

Author Alison Hook, International adviser
Contact Details alison.hook@sra.org.uk 07581 387803

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Annexes
Annex 1 Responses to consultation
Annex 2 Impact statement

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Responses to consultation

1 On 30 September 2014 we issued a consultation document seeking views on proposals to modify the rules in relation to overseas accounts. The proposals were designed to ensure that regulation is proportionate and targeted, with the aim of reducing costs for legal services providers.

2 The consultation closed on 22 December 2015. This report summarises the key points emerging from the responses.

3 A summary of the answers to the questions posed is set out below. A breakdown of the composition of respondents and a list of those respondents who consent to their details being publicised is contained below.

Question 1: Do you agree with our proposal to relocate the new overseas accounts provisions from the SRA Accounts Rules 2011 into the Overseas Rules? Is anything lost in doing so?

4 The majority of respondents agreed that the accounts provisions should be moved into the Overseas Rules. One respondent argued that taking the overseas accounts rules out of main accounts rules would mean that offices overseas would no longer be clear on whether or not to use SRA Accounts Rules as guidance if they were unsure about interpreting the existing overseas rules. A number of other respondents, however, argued that one of the benefits of a clearer separation between overseas and domestic accounts rules was to avoid the application of inappropriately detailed domestic rules in an international environments.

Question 2: Do you agree with the proposed changes to the application of these overseas accounts rules? More practices will be covered by the new rules, but it should be easier to understand what does and does not apply.

5 Respondents all agreed that the current application of the overseas accounts rules was too complex and caused overseas practices to fall in and out of coverage by the rules.

Question 3: Do you agree with our proposed simplification of the substance of the overseas accounts rules, as set out in new overseas rule 5.1, when compared to rules 50.3-50.6 in the existing Solicitors Accounts Rules?

6 There were a number of detailed comments made by respondents on the proposed substance of overseas rule 5.1. As a result of the responses we have added provisions relating, for example, to the treatment of interest and to unclaimed client balances.

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Question 4: Do you agree with our proposed new definition of client money overseas? Are there any concerns about risks this might pose either to consumers or third parties?

7 There was widespread disagreement with our proposed new definition of *client money overseas* , which was felt to be insufficiently clear. However, a number of respondents suggested some useful alternative drafting which we have adopted and which achieves the objective of broad compatibility with the definition of *client money* applying domestically, thus ensuring the same level of consumer protection, for example in relation to withdrawals from client account..

Question 5: Do you agree with our proposal to eliminate the requirement for accounts to be automatically submitted in respect of overseas practices?

8 Some of the respondents were unhappy about removing the standing requirement for accountants' reports in relation to overseas practices holding client money. However, these concerns either related to an apparent contradiction with the approach taken domestically or to a concern that overseas practices were somehow 'more risky' and therefore needed to be more closely monitored and to have a 'deterrent' effect in place.

9 In reviewing these concerns, we took into account the evidence on the accountants reports from overseas practices which we had received over the past five years and the fact that the rules governing accounts overseas will now be embedded in the overseas rules which has its own reporting obligations.

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Respondents to the Consultation

Type of respondent	**Responses**
Law firms / solicitors	2
Accountancy firms	1
Representative groups, trade and membership associations	2
Local Law Societies	1
TOTAL	6

This list includes only those who have agreed to their names appearing in a list of respondents.

Representative groups, trade and membership bodies, professional bodies

Junior Lawyers Division's of The Law Society
The Law Society

Local Law Societies

City of London Law Society

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Impact Statement

1. This impact statement comprises an assessment of the reforms to the SRA Accounts Rules 2011 ('the Accounts Rules') in relation to overseas practices and to the Overseas Rules 2013 ('the Overseas Rules') against our regulatory objectives, as also considered in light of our public sector equality duty and the better regulation principles.

Protecting and promoting the public interest

2. It is in the public interest that SRA regulated firms and individuals account for client money correctly, but that any regulation is proportionate so as not to unduly restrict access to services. In relation to the Overseas Rules, the SRA retains the right to ask for accountants reports in relation to overseas practices but will not do so as a matter of course.

Supporting the constitutional principle of the rule of law

3. We do not consider that these reforms will have a significant impact on this principle.

Improving access to justice

4. This is not a direct consideration in relation to the changes in the Overseas Rules.

Protecting and promoting the consumer interest

5. It should be noted that, the vast majority of overseas business is transacted for business clients (as opposed to business for UK residents instructing England and Wales based solicitors to act for them in another jurisdiction).

6. The amended rules do not substantively change the way in which SRA authorised persons or bodies overseas should deal with client money. The new rules continue to require the same standards but in a simplified and clearer form. Providing clear and more accessible rules will likely aid compliance, to the benefit of consumers. Changes to the reporting requirements should not reduce our knowledge of whether client money overseas has been mishandled, it will simply alter the mechanism through which this happens, from a local accountant's report to a report from the responsible authorized body.

7. The amendments do enhance, and provide consistency of, consumer protection by bringing all overseas practices and individuals practicing overseas within the application of the overseas accounts rules, irrespective of the mechanism through which they do so. We have brought the definition of client money (overseas) into alignment with domestic provisions, subject to a few small changes to reflect different circumstances prevailing

overseas (e.g. instead of specifying payment of 'stamp duty', the definition overseas refers to 'taxes, duties or fees payable').

Promoting competition in the provision of services provided by authorised persons

8. In terms of the Overseas Rules, the proposed changes will create a level playing field for firms with overseas offices. The application of the rules will no longer depend on the precise composition of the management of any particular office and will in future depend solely on its relationship with the 'responsible authorised body'. The changes will also remove the need for duplicate reports – currently many other jurisdictions already require firms to obtain reports for these offices.

Encouraging an independent, strong, diverse and effective legal profession

9. The numbers of firms affected by the Overseas Rules changes are small. The proposals may help facilitate firms to operate globally. This may assist the encouragement of a diverse legal profession but it not possible to obtain data to accurately forecast likely impacts.

10. The immediate beneficiaries from the proposed changes will be larger firms with networks of branch offices around the world as much overseas practice is carried out by larger firms. The current rules on reporting have mainly affected large these large international firms to date. There are some smaller firms with offices in other jurisdictions. The simplification in the application of the Overseas Rules for them will mean that the costs and complexity of running an overseas branch would be reduced. Further, market intelligence suggests that there are a growing number of smaller firms looking to set up overseas offices. The new rules will provide a clearer framework for those wishing to set up overseas offices in future. It is worth noting that the practice of most small firms with overseas offices to date has been to establish representative offices which do not hold client money.

Increasing public understanding of citizens' legal rights and duties

11. We do not consider these measures will have a significant impact on this objective one way or the other.

Promoting and maintaining adherence to professional principles by authorised persons

12. The proposed reforms to the Overseas Rules are designed to promote the professional principles relating to the protection of client assets and money. They do so by expanding the application of the Overseas Rules to all bodies overseas that are under the de facto or de jure control of SRA authorised bodies. They also encourage adherence to this principle by emphasising its primacy whilst allowing for greater flexibility as to how it is to be met.

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The better regulation principles: proportionality, accountability, consistency, transparency and targeted.

13. We believe that these measures support the following better regulation principles in particular:

- Proportionate
- Targeted
- Consistent
- Transparent

14. The amendments to the Overseas Rules will meet these principles by removing unnecessary complexity in the application of these rules and applying clearer principles more consistently across operations overseas that are under the de facto or de jure control of authorised bodies in England and Wales.