

CP11/13^{★★}

Financial Services Authority

Authorised professional firms and legal services reform

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The Financial Services Authority invites comments on this Consultation Paper. Comments should reach us by 12 August 2011.

Comments may be sent by electronic submission using the form on the FSA's website at: www.fsa.gov.uk/Pages/Library/Policy/CP/2011/cp11_13_response.shtml.

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Copies of this Consultation Paper are available to download from our website – www.fsa.gov.uk. Alternatively, paper copies can be obtained by calling the FSA order line: 0845 608 2372.

Acronyms used in this paper

CASS	Client Assets sourcebook
COBS	Conduct of Business sourcebook
ICOB	Insurance: Conduct of Business sourcebook
IMD	Insurance Mediation Directive
FSCS	Financial Services Compensation Scheme
FSMA	Financial Services and Markets Act 2000
MCOB	Mortgages and Home Finance: Conduct of Business sourcebook
MiFID	Markets in Financial Instruments Directive
ombudsman service	Financial Ombudsman Service
PROF	Professional Firms sourcebook
SRA	Solicitors Regulation Authority
SUP	Supervision manual

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Overview

Background

- 1.1 From October 2011, the Legal Services Act 2007 establishes ‘alternative business structures’ in England and Wales, with the intention of promoting competition within the provision of legal services. This will allow non-law firms to provide legal services and will introduce more flexibility in the management and financing of law firms.
- 1.2 The Legal Services Board will designate licensing authorities for the new structures and these authorities will include some designated professional bodies¹, whose members carry out financial services business as professional firms.
- 1.3 There are three types of professional firm:
 - exempt professional firms, which are exempt from FSA authorisation², and number approximately 17,000;
 - firms authorised by us to carry out non-mainstream regulated activities; and
 - firms authorised by us to carry out mainstream regulated activities.

There are some 300 firms from across the professions in the latter two categories (some of which carry out both mainstream and non-mainstream activity) and although they are authorised they benefit from certain exemptions from, or modifications to, our Handbook. These vary depending on the scope and level of their financial services activities.

1 There are ten designated professional bodies designated by the Treasury under section 326 of the Financial Services and Markets Act 2000 (FSMA) covering law, accountancy, actuarial services and chartered surveying. They are: the Law Society of England & Wales; the Law Society of Scotland; the Law Society of Northern Ireland; the Institute of Chartered Accountants in England and Wales; the Institute of Chartered Accountants of Scotland; the Institute of Chartered Accountants in Ireland; the Association of Chartered Certified Accountants; the Institute and Faculty of Actuaries; the Council for Licensed Conveyancers; the Royal Institution of Chartered Surveyors.

2 Part XX of FSMA provides an exemption from FSA authorisation in defined circumstances for certain incidental activities carried on by firms which are regulated by designated professional bodies designated under section 326 of FSMA.

- 1.4 We have previously confirmed that, in principle, firms operating as alternative business structures will be able to be authorised professional firms under our regime, meaning that they would benefit from the exemptions and modifications referred to above. These benefits operate on the assumption that the firm's designated professional body has its own rules in place to cover the firm's FSA-regulated activities.
- 1.5 The Law Society of England and Wales is a designated professional body, and its independent regulatory body, the Solicitors Regulation Authority (SRA), has applied to become a licensing authority under the Legal Services Act. It has recently decided that its jurisdiction under the Legal Services Act does not extend to the financial services activities of an alternative business structure, where that firm is FSA authorised.³
- 1.6 Consequently, it will not be regulating the financial services activities of an FSA-authorised alternative business structure. Because of the way the current exemptions and modifications work, the impact is that from October:
- firms carrying out mainstream regulated activities would not be subject to any rules in the areas of compensation and client money; and
 - firms carrying out non-mainstream regulated activities would be subject to a modified FSA regime in a range of areas⁴, despite the SRA no longer regulating their financial services activities.

We believe this would significantly undermine consumer protection.

- 1.7 It is for the SRA, not us, to decide on interpretation of the Legal Services Act, and we need to account for the possibility that other licensing authorities will adopt the same approach in future. In addition, the SRA has confirmed that it plans to consult in the near future on excluding from its jurisdiction the financial services activities of traditional law firms (authorised professional firms which are not alternative business structures). While we cannot predict the outcome of that consultation, if implemented, it would mean that clients of all authorised professional firms under the SRA would lack regulatory protection in the areas set out above.

Purpose of this Consultation Paper

- 1.8 In this paper, we are consulting on changes to the FSA Handbook designed to address both the gap in regulatory protection that will arise from October, and the longer term issue arising from the possibility that designated professional bodies will adopt a similar approach for traditional law firms. The paper also invites views on the potential costs and benefits of the proposed changes.

³ Exempt professional firms are not affected by this issue.

⁴ The key areas are requirements on reporting, approved persons, conduct of business, client accounts, training and competence, complaints handling and the compulsory jurisdiction of the ombudsman service.

Summary of the proposals

- 1.9** Our proposal is to close the gap in consumer protection by removing the exemptions and modifications in the FSA Handbook for professional firms (including alternative business structures) which will be authorised professional firms, but only where the designated professional body does not apply rules covering the firm's FSA-regulated activity.
- 1.10** Our Handbook distinguishes between two types of activities conducted by authorised professional firms: mainstream and non-mainstream. For mainstream regulated activities, we propose to add text in the Client Assets, Supervision and Glossary sections of the Handbook which brings firms carrying out these activities back within the scope of our rules, effectively withdrawing the special exemptions and modifications for the affected group alone.
- 1.11** For non-mainstream firms, we propose to amend the Professional Firms sourcebook (PROF) so that a professional firm regulated by a designated professional body which has switched off its rules cannot fall into the non-mainstream category. Instead, we would treat the firm as if it conducted mainstream regulated activities, and it would be subject to most FSA requirements.
- 1.12** We have drafted the changes so they will cover any designated professional body which decides to switch off its rules for FSA-regulated activities in relation to alternative business structures. They also address any similar moves by designated professional bodies in relation to traditional law firms.

Structure of this paper

- 1.13** The remainder of this paper is set out as follows:
- Chapter 2 summarises the issue and discusses the options considered
 - Chapter 3 contains our proposals
 - Annex 1 sets out our cost-benefit analysis and compatibility statement
 - Annex 2 explains the categories of authorised professional firm
 - Annex 3 lists the questions contained in this consultation paper
 - Appendix 1 sets out draft Handbook text

Who should read this paper?

- 1.14 This paper is relevant to members of the professions who carry out financial services activities, and to their trade associations and designated professional bodies. It is also relevant to clients of these firms and consumer bodies. Finally, it is relevant to the wider firm population which is subject to and funds the Financial Services Compensation Scheme (FSCS) and Financial Ombudsman Service (the ombudsman service).

Equality and diversity considerations

- 1.15 We have considered the likely equality and diversity impact of our proposals.
- 1.16 Certain groups are potentially more affected by our changes, due to the legal profession being over-represented compared to the UK population in terms of males, older people, and black, minority and ethnic people. On balance, we believe these proposals are a justified and proportionate means of protecting consumers. As part of our ongoing supervision of professional firms we will monitor the impact of any changes implemented and consider whether we need to make any adjustments.

Q1: Do you have any comments on the equality and diversity impact of our proposals?

Next steps

- 1.17 This consultation closes on 12 August 2011. We will finalise our rules in light of responses, and publish a Policy Statement in September with a view to the rules taking effect from 1 October 2011. The consultation period has been shortened because we have had relatively short notice of this issue and must have final rules in place when the relevant part of the Legal Services Act comes into force. Because of the shortened consultation period we will highlight this consultation to key stakeholders and invite their feedback.

CONSUMERS

This paper has implications for consumers of professional firms which carry out financial services activities, and consumer groups representing these individuals. The proposals aim to maintain the level of consumer protection that would be present had the SRA's rules for financial services activities been extended to alternative business structures that are FSA authorised. Without these changes, from October, alternative business structure firms licensed by the SRA and FSA authorised would not be subject to any rules in the areas of compensation scheme and client money. The potential benefits are therefore that the clients of such firms remain adequately protected.

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Issue and discussion of options

Background

- 2.1 From October 2011, the Legal Services Act 2007 establishes ‘alternative business structures’ in England and Wales, with the intention of promoting competition in the provision of legal services. This will allow non-law firms to provide legal services and will introduce more flexibility in the management and financing of law firms. These reforms, along with those arising from the Legal Services (Scotland) Act 2010, have a number of implications for us.
- 2.2 At present, our Handbook Glossary defines a *professional firm* (which in turn drives the definition of an *authorised professional firm*) as one which is either:
- an individual who is entitled to practise a profession regulated by a designated professional body and subject to that designated professional body’s rules; or
 - a person (not being an individual) which is controlled and managed by one or more such individuals.
- 2.3 The creation of alternative business structures challenges the second part of this definition because they give more flexibility around ownership and management. Consequently, we told the SRA’s multi-disciplinary practice working group that we would be willing to consult to amend the Glossary definition to state that they must be ‘controlled or managed’.⁵ At the same time, we provided our interpretation of the meaning of these terms.
- 2.4 This change will facilitate alternative business structures becoming authorised professional firms and therefore benefiting from a number of special exemptions from, or modifications to, our rules.

⁵ This will align it with the definition in FSMA for exempt professional firms.

- 2.5 The basis of these exemptions and modifications is that for its FSA-regulated activities the firm is subject to the rules of its designated professional body. In the case of non-mainstream regulated activities, it also allows firms which are carrying out these activities to operate on a level playing field with exempt professional firms.
- 2.6 Firms undertaking non-mainstream regulated activities benefit most, but are more limited in the regulated activities they can carry out. We set out in Annex 2 the distinction between mainstream and non-mainstream regulated activities and how this drives the application or otherwise of our Handbook.

The issue

- 2.7 This consultation contains proposals to address the immediate issue of the regulatory gap which will arise from 6 October 2011, when alternative business structures are established in England and Wales.
- 2.8 Members of the professions may carry out financial services business as either exempt or authorised professional firms. Exempt professional firms,⁶ numbering approximately 17,000, are exempt from FSA authorisation and are regulated by designated professional bodies. Authorised professional firms, numbering approximately 300, may carry out non-mainstream regulated activities, mainstream regulated activities, or some mix of the two.
- 2.9 Alternative business structures could – in theory – be either exempt professional firms or authorised professional firms.
- 2.10 The SRA⁷ has consulted on changes to its regulatory regime to accommodate alternative business structures. Its view⁸ is that, where these firms are FSA authorised, the activities subject to conditions of licensing may not include financial services.
- 2.11 Consequently, it will not be regulating the financial services activities of an FSA-authorised alternative business structure. Because of the way the current exemptions and modifications work, the impact is that from October:
- firms carrying out mainstream regulated activities would not be subject to any rules in the areas of compensation and client money; and

6 Part XX of the Financial Services and Markets Act 2000 (FSMA) provides an exemption in defined circumstances for certain incidental activities carried on by firms which are regulated by professional bodies designated under section 326 of FSMA ('designated professional bodies'). PROF 2 gives guidance on the definition of incidental activities, which relate to both the scale of business conducted and the way it is marketed. Our view is that alternative business structures can in principle meet the necessary definitions in FSMA to be exempt professional firms.

7 The Law Society of England and Wales is a designated professional body, and its independent regulatory body, the SRA, has applied to become a licensing authority under the Legal Services Act. Its members will, in principle, be able to meet the definition of an authorised professional firm.

8 It is for the SRA, not us, to decide on interpretation of the Legal Services Act, and we need to account for the possibility that other licensing authorities which are designated professional bodies will take the same interpretation in future, both for alternative business structures and traditional law firms.

- firms carrying out non-mainstream regulated activities would be subject to a modified FSA regime in a range of areas, despite the SRA no longer regulating their financial services activity.
- 2.12** The SRA has also confirmed that it plans to consult in the near future on widening this approach to traditional law firms (authorised professional firms which are not alternative business structures). While we cannot predict the outcome of this consultation, if implemented, it would mean that clients of all authorised professional firms under the SRA, and not just alternative business structures, would lack regulatory protection in the areas set out above.
- 2.13** We believe that this would significantly undermine consumer protection. The rules around client money and compensation play a key role in protecting consumers. In addition, the modified application of the rules for non-mainstream regulated activities means that clients depend on the requirements of the designated professional body. Our view is that consumers need the protection offered by these rules. The rationale is explained in the market failure analysis set out at Annex 1.

Policy intention

- 2.14** Our objective is to put firms and consumers back in the position they would be in had this issue not arisen. To do this, we propose to remove the exemptions and modifications in the Handbook for professional firms (including alternative business structures) which will be authorised professional firms, but only where the designated professional body does not apply rules covering the firm's financial services activities. This will close the gap in consumer protection.
- 2.15** We have assumed that the relevant parts of the Legal Services Act will be implemented on 6 October, as currently planned, but we understand there is the possibility of delay in the SRA becoming a licensing authority. If there is a delay, early implementation of our proposed rule changes will have no detrimental effect because alternative business structures under the SRA will not exist. On the other hand, not having rules ready in time for 6 October risks leaving consumers unprotected.
- 2.16** The Legal Services (Scotland) Act 2010 aims to achieve a similar reform of the Scottish legal profession, including the licensing of alternative business structures. This Act is running to a different timetable, so the issue is at present limited to England and Wales, but our proposed solution pre-empts similar issues arising in Scotland.

Options considered

- 2.17 We set out here the options that we considered in developing the proposals that we set out in Chapter 3.
- 2.18 *Option 1* – We considered making no change, and allowing financial services activities to be carried out without compensation and client money protections. Designated professional bodies switching off their rules would instruct their members that, on becoming alternative business structures, they would have to make their clients aware of the lack of protection in the relevant areas.
- 2.19 We discounted this option on the basis that disclosure by the firms affected would be unlikely, at least in the short term, to alter the behaviour of firms or consumers. Instead the impact would only become apparent in cases where problems arose and redress was sought. Our view is that this is inconsistent with our statutory objectives and the original intention of the professional firms regime.⁹
- 2.20 *Option 2* – change the Handbook so that alternative business structures could not be authorised professional firms.
- 2.21 This option would have a negative impact on competition because ABSs that would otherwise be authorised professional firms wanting to carry out financial services activities would not be able to take advantage of the professional firms regime. This would contrast with other firms that were not ABSs and could therefore still be authorised professional firms. While this would meet our objective of ensuring consumer protection for customers of these firms, we believe that this could be a disproportionate response given that only one designated professional body has currently decided to switch off its rules for financial activities.
- 2.22 *Option 3* – change the Handbook so that only the alternative business structures regulated by the SRA would be prevented from being authorised professional firms.
- 2.23 In this case alternative business structures regulated by the SRA would have to be fully authorised by the FSA. While this option would address the immediate issue, key consumer protections would be removed if either the SRA proceeded to switch off its rules for traditional law firms as planned, or if other designated professional bodies took a similar approach to the SRA. We therefore do not believe that this option is sufficiently future-proof.
- 2.24 *Option 4* – change the Handbook so that alternative business structures under any designated professional body would be prevented from being authorised professional firms, but only where the designated professional body had disappplied its financial services rules.

⁹ The basis of these exemptions and modifications is that for its FSA-regulated activities the firm is subject to the rules of its designated professional body. In the case of non-mainstream regulated activities, it also allows firms which are carrying out these activities to operate on a level playing field with exempt professional firms.

- 2.25 In this case an alternative business structure could qualify as an authorised professional firm, but only where the body in question had not decided to switch off its rules for financial services activities. This would address the immediate issue and possible future moves by other designated professional bodies to follow the SRA's approach, but would not address any widening of this approach to traditional law firms. So it would potentially only meet our objective in the short term.
- 2.26 *Option 5* – remove the gap in consumer protection by removing the exemptions and modifications in the Handbook for professional firms (including alternative business structures) which will be authorised professional firms, but whose designated professional body does not have rules covering the firm's financial services activities.
- 2.27 This means that both alternative business structures and traditional law firms could take advantage of the authorised professional firms regime, but only where their designated professional body has rules covering financial services activities. Where the designated professional body no longer applies rules for these activities, the effect would be to withdraw the special exemptions and modifications for this group of firms alone.

Preferred option

- 2.28 Our preference is for option 5 set out above. We see no option but to address the gap in consumer protection, and believe this to be the most proportionate method.

3

Proposals

- 3.1 As noted in Chapter 2, our preferred option is to remove the exemptions and modifications in the Handbook for authorised professional firms (including alternative business structures) whose designated professional body does not apply rules covering the firm's financial services activities.
- 3.2 Making this change adds an additional layer of complexity to the professional firms regime, because there will be authorised professional firms which are not able to take advantage of the exemptions from and modifications to our rules. However, on balance, and in the time available, we believe it is the best option.
- 3.3 We also propose to amend the Handbook Glossary definition of a *professional firm* to clarify that it can be 'controlled or managed' by a member of a profession. This will align the Handbook with FSMA, which we believe was the original intention, and will enable alternative business structures to take advantage of the professional firms regime.
- 3.4 We have also taken the opportunity to provide additional guidance on the terms controlled and managed, confirming what we told the SRA's multi-disciplinary practice working group in August 2010. The essence of this guidance is to make clear that a manager must have sufficient overall oversight of the firm.
- 3.5 Our proposed change to the definition of *professional firm* in the Glossary spans mainstream and non-mainstream regulated activities.
- 3.6 The other proposed changes depend on whether the firm's activities are mainstream or non-mainstream. The draft Handbook text to make these amendments is shown at Appendix 1.

Mainstream regulated activities

- 3.7 For mainstream regulated activities, we are proposing amendments to the Client Assets,¹⁰ Supervision¹¹ and Glossary sections of the Handbook, bringing these firms back within the scope of the relevant rules.

Client Assets

- 3.8 Currently, authorised professional firms regulated by one of three legal designated professional bodies¹² are deemed to comply with various sections of this part of the Handbook if they comply with the rules of their designated professional bodies.¹³ With regard to these specific sections of the Handbook, our changes intend that authorised professional firms regulated by a legal designated professional body will either comply with the rules of that body or the corresponding FSA rules.

Supervision

- 3.9 Authorised professional firms regulated by three of the legal designated professional bodies (as for client assets above) and their auditors are not currently in scope of certain parts of the Supervision section of the Handbook relating to client money. Again, our proposed changes intend to ensure that authorised professional firms are subject to the rules of either their designated professional body or the FSA rules.

Glossary

- 3.10 Our changes amend the definition of ‘participant firm’, which is currently drafted to exclude authorised professional firms of the law societies of England/Wales and Scotland. Where the designated professional body has switched off its rules in relation to financial services activities, our change brings its members back within scope of the Compensation sourcebook and Fees 6 chapter of the Handbook, which means that consumers will be protected by the FSCS and these firms will therefore have to pay FSCS levies.

10 This section of the Handbook sets out the requirements relating to holding client assets and client money.

11 This section of the Handbook sets out our supervisory provisions including those relating to auditors, waivers, individual guidance, notifications and reporting.

12 The Law Society of England & Wales, the Law Society of Scotland, and the Law Society of Northern Ireland.

13 The relevant rules are set out in CASS 5.1.4R or CASS 7.1.15R (2).

Non-mainstream regulated activities

- 3.11** We will address non-mainstream regulated activities by amending the Professional Firms sourcebook (PROF) so that a professional firm regulated by a designated professional body which has switched off its own rules for financial services activities cannot be classified as carrying out non-mainstream regulated activities. Instead, those activities would be treated as normal regulated activities, and would be subject to the majority of FSA requirements (see Annex 2).
- 3.12** For the firms affected, these rule changes bring them within scope of a number of sections of the FSA Handbook, as listed at PROF 5.3.1A G to PROF 5.3.10 G. The key areas are requirements on reporting, approved persons, conduct of business, client money, training and competence, complaints handling and the compulsory jurisdiction of the ombudsman service. In addition, because these firms will now be carrying out mainstream activities, the changes for those firms as described above will also apply, covering client money and compensation. These and other areas are set out in detail in our cost benefit analysis at Annex 1.
- 3.13** We are aware that there may be some practical issues for firms arising from our changes, but for the relatively limited number of firms potentially concerned and in the time available, we did not think it was practical to create transitional provisions. However, we would like to understand better the issues faced by firms in meeting the new requirements, given the range of business models and therefore the varying impact of our changes. We encourage firms to contact us to discuss these issues.

Q2: Do you agree with our preferred option?

Q3: Do you agree with our proposed rule changes?

Q4: Do you have any comments about the costs and benefits set out in Annex 1?

Annex 1

Cost benefit analysis and compatibility statement

1. Section 155 of FSMA requires us to publish a cost benefit analysis (CBA) when we propose new rules, or amendments to rules, unless we consider the proposals will result in no costs or to an increase in costs of minimal significance. This CBA therefore estimates the costs and analyses the benefits that will arise from the proposals we set out in Chapter 3. It is a statement of the differences between the position that would arise in October if we did not take any action (including current designated professional body requirements) and the position that will arise if we implement our proposals.
2. The costs presented in this analysis represent the incremental compliance costs a firm could incur compared to those of its current designated professional body (DPB) rules. Our baseline for assessing what is incremental presumes that firms already have processes in place in some of the areas where we are now proposing to switch our rules back on. This is because our professional firms regime is predicated on the DPBs having their own rules in place to cover the firm's FSA-regulated activities. Therefore many of the incremental costs are minimal, although some are more significant. These reflect the cost of complying with FSA requirements but as we state in Chapter 2 we have no choice but to make these changes.
3. If we don't make these changes, in October, some existing authorised professional firms under the SRA could become alternative business structures, and could continue to meet the FSA Handbook criteria for being a professional firm. As such, they would continue to benefit from the modifications and exemptions under the professional firms regime, but, due to the SRA changes, would not be subject to regulation by the SRA.
4. Firms in this category are within scope of this CBA because, as alternative business structures under a DPB which has switched off its rules, they will be affected by the rule changes we are proposing. In theory, traditional law firms could also be affected if their DPB switches off its rules for them.

5. Other existing authorised professional firms could become ABSs, but – without our changes to the definition of professional firm – would no longer be able to be authorised professional firms because they would cease to meet the criteria in terms of ownership and management. Firms in this category benefit from the changes we are proposing because they can continue to be APFs, and we maintain the same level of consumer protection.
6. New firms could potentially come into the marketplace in future as authorised professional firms which are alternative business structures. The regulatory framework in place at the time they decide to join is a factor in the decision they make to enter financial services. Therefore we have analysed the potential impact of our proposals on market entry.
7. Because of the changes proposed by the SRA, many processes undertaken by firms for the SRA may reduce in scope, but will not stop. Therefore undertaking similar processes to meet FSA requirements will represent an additional requirement. In addition, where responsibilities transfer from the SRA to the FSA, firms may find operating under the FSA regulatory regime results in additional regulatory requirements. This is more probable for alternative business structure firms that undertake regulated financial activities on a non-mainstream basis.
8. We expect the size of the total incremental compliance costs to vary across firms. There will be some firms whose current operations already meet FSA requirements so they may not incur these incremental compliance costs, in part, or at all. Therefore an individual firm's total incremental compliance costs will vary according to its current practice.

Methodology

9. This CBA reflects analysis undertaken within the FSA and the results of consulting the ten DPBs and Solicitors Independent Financial Advice (SIFA). We present the analysis of the impacts of our proposals on the two types of activities (explained in Annex 2) undertaken by authorised professional firms:
 - mainstream regulated activities; and
 - non-mainstream regulated activities.

Our proposals will re-classify non-mainstream regulated activities as mainstream activities for the firms affected, with the result that the incremental cost impacts for mainstream firms will also apply.

Population of firms

10. The issue we are addressing currently relates only to certain SRA firms from October, but as explained in Chapter 2, we are taking the opportunity to pre-empt any similar issues arising in relation to firms regulated by other DPBs in future. To that extent, the costs set out here can be seen as a proxy for the costs to firms regulated by other DPBs if they decide to take similar steps. We have no reason to assume that the costs for such firms would be materially different.
11. Based on the SRA's expectations, only 12 firms will be affected by our proposals from 6 October 2011. A further 377 firms¹ are already operating as Legal Disciplinary Practices and as such have to convert to alternative business structures by 31 October 2012, at the latest. This group may therefore be affected by our proposals, however many of them are not carrying out financial services activities, meaning that the actual number affected will be lower.
12. Further, some of the firms noted above are not within scope of this analysis, because without the change we are making to the professional firm definition, they would not be able to be authorised professional firms.
13. We do not know how many firms, currently regulated by a DPB, want to provide financial services as an alternative business structure because the legislation has not come into force. There are also various business models in current and potential future use, and firms may or may not incur costs depending on their size, income, and activities they choose to undertake.
14. As a result, we are unable to estimate the total industry costs but instead use currently available information to estimate example incremental compliance costs for an alternative business structure firm providing financial services. We therefore encourage firms to provide us with information that may impact on these estimates as part of the consultation process.

Incremental compliance costs

Firms undertaking mainstream regulated activities

15. As discussed in Chapter 3, firms which carry on mainstream regulated activities will be required to:
 - meet our client money requirements²; and
 - contribute to the costs of the FSCS.
16. We have summarised the estimated costs of meeting these requirements in Table 1.

1 Legal Disciplinary Practices (LDPs) figure from *SRA Summary of Performance Measures and Statistics March 2011*, SRA, 28/4/11: www.sra.org.uk/documents/SRA/performance/compliance-record-sra-quarter1-2011.pdf.

2 Firms in this category which are not currently subject to CASS 6 (custody rules) will under our proposals become subject to our CMAR/CASS reporting, CF10a/CASS operational oversight and auditor's client assets report requirements.

Table 1: Summary of incremental compliance cost estimates for a firm undertaking mainstream activities

Type of compliance cost	One-off costs per firm	Ongoing costs per firm each year*
FSCS levies	Minimal	Average of £1,500 ³
Set up and maintain segregated client money (CASS 5 and/or 7)	£120 – £240 ⁴ Bank fees assumed minimal	At a maximum of £25 per client ⁵
Client Money and Asset Return (CMAR) for CASS medium and large firms ⁶	£5,000 ⁷	£960 – £8,500 ⁸
CASS small firms reporting	Minimal	£50 ⁹
Approved Person – controlled function CF10a – CASS oversight ¹⁰	£200 + £1,850 for larger firms ¹¹	As per one-off costs depending on staff turnover

- 3 FSA internal COGNOS data May 2011. We analysed data from non-legal APFs (which are subject to FSCS levies) and have assumed that they have sufficiently similar income levels and business types for us to use them as a guide for law firms.
- 4 2-4 hrs work at a rate of £60/hr including overheads, using Office of National Statistics (ONS) data (Table 14.5a – Hourly gross pay for all employee jobs, 2010, assuming pay is equivalent to the 90th percentile of financial managers and chartered secretaries, to reflect a financial services uplift). We are also assuming no incremental systems costs, as firms in question are likely to have systems in place to track and segregate client money already.
- 5 Using the estimated cost of compliance with all of CASS published in CP06/14 *Implementing MiFID for Firms and Markets*, updated for inflation giving approximately £50 per client. We assume that at least half of these costs do not relate to our client money rules in CASS 5 & 7. Therefore we consider £25 per client per firm as an upper limit for estimating the costs of our client money rules. This cost may vary by firm size (i.e. firms with a higher number of clients are likely to have a lower ongoing cost, whereas firms with fewer clients may incur higher ongoing costs due to economies of scale in fulfilling CASS 5 and 7 requirements).
- 6 For definitions of these firm types see <http://fsahandbook.info/FSA/html/handbook/CASS/1A/2>. Authorised professional firms to whom CASS 6 (custody rules) currently applies must already meet our small firm and CMAR reporting requirements. A firm is subject to CASS 6 when it holds financial instruments belonging to a client in the course of its MiFID business; and/or when it is safeguarding and administering investments, in the course of business that is not MiFID business.
- 7 CP10/9: *Enhancing the Client Assets Sourcebook*, March 2010. The one-off cost is the average provided by medium and large firms, although we consider this to be an absolute upper bound.
- 8 CP10/9. The range of ongoing costs indicates upper and lower bounds, where the lower bound represents an internal FSA estimate, whereas the upper bound is the average of responses to the firm survey used to assess the costs of introducing CMAR for large and medium sized firms.
- 9 CP11/4 *The Client Money and Asset Return (CMAR): Operational Implementation*, Annex 1.
- 10 In practice we expect that few, if any, firms will fall into this CASS category – CASS small firms (see CASS 1A.2.7R) do not require a CF10a. However, CASS small firms are required to allocate responsibility for CASS operational oversight to a member of the firm's governing body. In cases where this is not an individual holding the Compliance Oversight controlled function (CF10), then a record of this allocation will need to be made.
- 11 CP10/9, Annex 1.

Type of compliance cost	One-off costs per firm	Ongoing costs per firm each year*
SUP 3.10 requirement to produce an auditor's client assets report	N/A	£1,000 – £127,000 This includes three elements: <ul style="list-style-type: none"> • producing the report, range from £700 to £125,000¹² • staff admin cost, averaged as £200¹³ • reviewing the findings of the auditor's report – between £200 and £2,000 annually¹⁴

* Key

Costs are considered minimal where there is a small difference between FSA requirements and those already in place or costs can reasonably be expected to be absorbed within parallel processes.

17. The professional services aspects of claims made against SRA regulated firms will continue to be covered by the SRA Compensation Fund, but the financial services claims will be covered by the FSCS. The SRA has indicated that in the short term they do not intend to offer a reduction in fees for their member firms for this change in the scope of their fund.
18. Firms will be required to contribute to FSCS' management expenses and compensation costs. The actual levy for compensation costs will depend on the funding class in which the firm falls, the amount of business the firm undertakes and the extent of any failures for which the FSCS pays out. These levies will be additional to the amount firms are already paying to the SRA in respect of the Compensation Fund. Our own data for existing non-legal APFs¹⁵ suggests an average of around £1,500.
19. Currently affected firms undertaking mainstream regulated activities are deemed to comply with CASS 5 and CASS 7 (client money rules), if they comply with the rules of their designated professional body. Our proposals would remove this provision, meaning that some of these firms will experience incremental costs associated with compliance with the client money rules in these two chapters, as appropriate.

12 We assume that producing the report would cost £140-500/hr for auditors, for between 5 and 250 hours, giving a range from £700 to £125,000.

13 Staff admin cost, averaged as £199 $((£44.20 \times (1+50\%)) \times 3 = £198.90)$ the figure £44.21 (occupation – corporate managers and senior officials) is from the ONS, 2010 Annual Survey of Hours and Earnings with 50% added to gross hourly pay to reflect the likely cost to the employer.

14 We presume this review body or committee will range in size from two to ten members. We understand that it will take the governing body about one hour to review the auditor's client assets report and as a result we expect that this will result in an ongoing annual opportunity cost for each firm of about £200 – £2,000, assuming one hour of governing body time to cost on average between roughly $((£70 \times (1+50\%)) \times 2 = £210)$ and roughly $((£70 \times (1+50\%)) \times 10 = £2,100)$ on the basis of the ONS data.

15 Which do not benefit from an exemption from the FSCS.

20. These firms must already comply in respect to those activities with our collateral rules (CASS 3), custody rules (CASS 6), and mandate rules (CASS 8) as appropriate. In addition, if they are already subject to CASS 6¹⁶, they should also already be meeting our requirements in CASS 1A (CMAR/CASS reporting, CF10a/CASS operational oversight) and SUP 3.10 (Auditor's client assets report). However, if these firms are not currently subject to our custody rules (CASS 6), then the implementation of our proposals will be the first time they need to meet our requirements in CASS 1A and SUP 3.10. As a result, firms in this latter category may experience additional incremental costs associated with the CMAR, CASS small firm reporting, CF10a/CASS oversight and the auditor's client assets report.
21. Apart from the costs for CASS medium and large firms in the appointment of a CF10a/CASS operational oversight and in setting up CMAR reporting, we do not consider that there are significant one-off costs from our changes for firms carrying out mainstream regulated activities. We consider that systems and IT costs associated with our client money rules in CASS 5 and 7 will be minimal, given that firms should already have systems in place to segregate and track client money.
22. There may be material ongoing costs for some of the firms affected – in particular in relation to ongoing monitoring of compliance with CASS 5 and 7 (client money rules) as well as in relation to the auditor's client assets report and the CMAR for CASS medium and large firms. We find other ongoing costs to be either minimal or insignificant for the reasons set out above.

Firms undertaking non-mainstream regulated activities

23. As discussed in Chapter 3 and set out in Annex 2, firms which carry on non-mainstream regulated activities will need to meet requirements including:
- FSA authorisation-related requirements;
 - conduct of business for investment, mortgage and non-investment insurance business;
 - complaints handling and participating in the ombudsman service's compulsory jurisdiction;
 - client money and assets; and
 - Other.
24. These costs are summarised in Table 2. For the reasons explained at paragraph 3.12, **firms undertaking non-mainstream activities will also become subject to the additional costs for mainstream activities, in relation to compensation and client money, and summarised in Table 1.**

¹⁶ A firm is subject to CASS 6 when it holds financial instruments belonging to a client in the course of its MiFID business; and/or when it is safeguarding and administering investments, in the course of business that is not MiFID business. CASS 6.1.1R.

Table 2: Costs to firms: summary of incremental compliance costs for a firm undertaking non-mainstream regulated activities

Type of compliance cost	One-off costs per firm	Annual ongoing costs per firm
<i>FSA authorisation-related costs</i>		
Approved persons – such as CF11 – MLRO, CF4 – Partner, CF30 – Customer	£200 ¹⁷ £1,850	minimal
Firm cancellation of permission	£300 – £2,600 ¹⁸	minimal
Firm new entity application ¹⁹	Fee in range £1,500 – £5,000 + £2,200 administration	minimal
Training and competence	£4,400 ²⁰ per individual, per activity	minimal
Complying with conduct of business requirements ²¹	£5,400	£4,500
<i>Complaints</i>		
Biannual complaints report (DISP)	N/A	Minimal for firms that have few (or no) complaints ²²
Financial Ombudsman Service	N/A	£460 (median) ²³ administration per complaint £500 case fee for the fourth and any subsequent cases ²⁴ £300 (average) ²⁵ administration per complaint considered by the ombudsman service
<i>Client Money and Assets – no costs in addition to those already noted in Table 1 above</i>		
<i>Other</i>		
Electronic reporting (RMAR) ²⁶	N/A	£3,600

17 These figures are an average cost of application for approval, based on assumptions used by FSA's authorisations division. £1,850 represents the estimated average one-off cost to a firm where an interview is required as part of the process.

18 Costs depend on the size and activity of firms and are based on telephone survey estimates provided as part of the *Estimation of FSA Third Party Administrative Burdens*, Real Assurance, June 2006.

19 Application fee varies depending on scope of permission. Admin cost based on Real Assurance Estimation of FSA Administrative Burdens, updated to 2011.

20 Costs will not necessarily rise linearly for multiple activities, as the underlying support structures would be the same, and some appropriate qualifications cover multiple activities. Costs are based on CP06/8: *Regulation of Home Reversion and Home Purchase Plans*, April 2006, and updated to 2011.

21 *Estimated Compliance Costs of Conduct of Business Regulation for General Insurance: A Report for The FSA*, National Economic Research Associates, 27/06/2003. Costs updated to 2011.

22 CP07/17 noted that 14,000 out of 18,564 firms (75%) reported nil returns in H2 of 2006, and of the 4,500 firms which reported complaints, almost 3,500 reported fewer than ten a year.

23 To inform CP10/21, we surveyed 159 firms of various sizes from different sectors. 85 firms responded.

24 The current case fee as at June 2011.

25 CP11/10 *Consumer complaints: the ombudsman award limit and changes to complaints-handling rules*, May 2011. www.fsa.gov.uk/pubs/cp/cp11_10.pdf

26 *Estimation of FSA Third Party Administrative Burdens*, Real Assurance, December 2006, updated to 2011.

25. As set out in Table 2, although this will depend on the size and business model of firms, we find the main costs for firms undertaking non-mainstream regulated activities to be as below.

One-off costs relating to:

26. FSA authorisation – this category covers approved persons changes, cancellations of permission, new entity applications and training and competence. These costs will vary significantly with a firm's business activities and size, and we have presented some of the costs on a per-unit basis to reflect this. Larger firms which have to apply for significant numbers of approved persons and meet their training and competence requirements are most likely to incur the highest costs.
27. However, it is important to note some factors that will reduce the costs from training and competence in practice. The SRA's code of conduct already requires individuals to provide a competent service and to have the skills required to carry out the client's instructions. Not all firms will need to add roles which bring FSA qualification requirements, which is the key part of this cost. Further, where there is a qualification requirement, the cost of studying will be reduced to the extent that individuals already possess some or all of the knowledge required. We therefore expect this cost to be significantly lower in many instances, although the reduction is difficult to quantify.
28. Conduct of business requirements – this cost is based on research carried out for the FSA's introduction of general insurance regulation, which indicated an average cost of £5,400 per firm. The main components of this were for systems and firms' internal supervision of the new requirements. We have taken this figure as an approximation for complying with any one of ICOBS, COBS (for investments) and MCOB (for mortgage business). Consequently, this cost will increase if firms are subject to more than one of these areas, but will not increase proportionately due to economies of scale.
29. The costs set out under conduct of business assume that firms are not currently meeting any of the FSA requirements in these areas. In fact, while the mapping is not straightforward, the requirements in the SRA's Principles and Code of Conduct will overlap with some of the conduct of business requirements. For example, the SRA's Principles 4 (acting in the best interest of clients) and 5 (providing a proper standard of service to clients) are relevant to suitability, and the Code of Conduct requirements around dealing with clients' matters are relevant to disclosure requirements. While this is very difficult to quantify, it means that the cost shown is an overestimate, particularly on an ongoing basis.
30. In relation to client assets requirements, we expect one-off costs to be minimal given the existing SRA recordkeeping, client money segregation and reconciliation requirements, which will have led firms to invest in the required IT and systems costs to be able to fulfil these requirements.

Ongoing costs relating to:

31. Conduct of business requirements – this covers requirements for advised sales of non-investment insurance products, including disclosure to clients, identifying client needs and suitability. As explained above, we have taken this figure as an approximation of the cost of complying with any one of the three conduct of business regimes, meaning that this cost will increase, but not proportionately, if the firm is also subject to COBS and MCOB. In general and again as noted above, existing SRA requirements will further reduce these figures in practice.
32. Electronic reporting (RMAR) – firms carrying out retail mediation activities must complete this return, at an estimated cost of £3,600 per year.
33. Regarding the incremental costs of compliance with CASS, when firms affected by our proposals are engaged in non-mainstream regulated activities, they do not currently need to meet our requirements in CASS. As a result of our proposals, these firms will need to start meeting all of our requirements in CASS. However, we assume that these firms will not be subject to CASS 6 because we are not aware of any firms engaged – on a non-mainstream basis – in the activities of holding financial instruments in the course of MiFID business and/or safeguarding and administering investments in the course of non-MiFID business. Therefore firms in this category should not experience any costs associated with our custody rules.
34. The only CASS-related costs remaining besides those in Table 1, which may affect firms engaged in non-mainstream regulated activities, relate to our requirements in CASS 3 (collateral rules) and 8 (mandate rules). We expect compliance with these requirements to generate less than minimal costs to firms because we would expect these firms to already be subject to rules (currently from the SRA) which requires them to maintain adequate records. Therefore the firms affected by our proposals will already be meeting these obligations and we do not expect any costs in addition to those set out in Table 1 to apply to firms engaged in non-mainstream regulated activities.
35. We estimate that the costs in the remaining areas will be either minimal or insignificant, as shown in Table 2 and the associated footnotes. In some cases, the nature of the cost means there is no ongoing element (e.g. for authorisation-related items), or the likely scale of firms' activities means that the costs will be small.

Direct costs to the FSA

36. While we do not anticipate an increase in the number of professional firms subject to regulation, there may be an increase in the proportion of firms which are subject to full regulation (compared to partial regulation under the professional firms regime) or which become subject to the more onerous form of regulation under the professional firms regime. We intend that the supervision and administration of client money, authorisation and approvals, and firms conduct of business will be met from the current FSA business plan and will not require additional resources.

Indirect costs from mainstream and non-mainstream activity alternative business structure firms

37. As a result of the SRA's decision and the implementation of our proposals, some mainstream and non-mainstream firms may have incentives to leave financial services markets due to the net compliance cost increase. Market exit reduces the number of distributors of financial products and could adversely affect competition.
38. However, there are a number of factors we consider will significantly limit the impact on competition from exit. There are 72 authorised professional firms under the SRA; this sets an upper limit on the number of SRA authorised professional firms that can be alternative business structures and thus the group that can be immediately affected by our proposals. We also know that of these 72, only 12 have definite plans to become alternative business structures from 6 October. We expect that this small volume of firms will undertake a limited amount of business.
39. To put this in context, there are approximately 120 authorised professional firms and over 11,000²⁷ exempt professional firms in the legal sector. An authorised professional firm carrying out mainstream activities competes with normal authorised (non-professional) firms. This means that there are many firms which already supply these services from outside the authorised professional firm regime, and will continue to do so.
40. Therefore, we consider overall that the small number of firms that could potentially exit given the current market size will not have a material impact on competition.
41. New entrant firms affected by this issue will be subject to more FSA regulation than they would have been absent our proposals, which could present a barrier to entry, but this is no different from other authorised firms.

²⁷ Based on the number of firms registered as exempt professional firms for Insurance Mediation activities

Benefits to consumers

42. Our proposals prevent a regulatory gap from opening up in October 2011 as a result of the SRA's decision not to give regulatory coverage to the financial activities of alternative business structure firms. We are maintaining current levels of consumer protection in key areas such as compensation and client money.
43. However, this CBA has identified a number of potential incremental costs from the proposed rule changes which means that maintaining the current level of consumer protection is likely to occur at a higher cost than experienced under current SRA regulation.

Compatibility statement

44. This section sets out our assessment of the compatibility of our proposals with our general duties under Section 2 of FSMA and with our regulatory objectives set out in Sections 3 to 6 of FSMA. We also outline how our proposals are consistent with our principles of good regulation to which we must have regard.
45. We consider that our proposals are the most appropriate way to achieve our objectives. As set out in Chapter 2, we have considered several options and our preferred option targets only the firms which are directly affected by this issue. This means that firms will be able to continue to take advantage of the authorised professional firms regime, provided their designated professional body has rules covering their financial services activities. In addition, the proposals pre-empt potential future changes, which would not be the case in the other options.

Compatibility with our statutory objectives

46. The proposals outlined in this CP are consistent with our statutory objectives of maintaining confidence in the UK financial system, and securing the appropriate degree of protection for consumers.

Consumer protection

47. If our proposals are not implemented it is likely that consumers will suffer detriment from removal of the protections mentioned above.

Compatibility with the principles of good regulation

The need to use our resources in the most efficient and economic way

48. Our proposals are neither the cheapest nor the fastest option available for implementation. However, we consider that our proposals provide an adequate level of protection against our statutory objectives. Our preferred option minimises the negative impact for designated professional bodies, firms and consumers and within its costs, our preferred option efficiently tackles a similar regulatory gap which is likely to arise in the near future.

The responsibilities of those who manage the affairs of authorised persons

49. Our proposals will ensure that there is increased oversight of those who manage the affairs of authorised persons, by way of increased reach of the FSA Handbook.

The burdens or restrictions we impose on the industry should be proportionate to the benefits that are expected to result from those burdens or restrictions

50. Our preferred option minimises the impact for designated professional bodies, firms and consumers, and within its costs tackles a similar regulatory gap which is likely to arise in the near future.

The desirability of facilitating innovation in connection with regulated activities

51. No material effect.

The need to minimise the adverse effects on competition that may arise from our activities and the desirability of facilitating competition between the firms we regulate

52. No material effect.

The desirability of enhancing the understanding and knowledge of members of the public of financial matters (including the UK financial system)

53. We expect that under our proposals, firms will be required to continue to deliver information to consumers after ABS implementation.

Annex 2

Categories of authorised professional firm

An authorised professional firm can carry out mainstream and/or non-mainstream regulated activities. Where a firm carries out both types of activity, a mix of the requirements set out below is applicable.

Mainstream authorised professional firms

1. These firms can be authorised by the FSA in the normal way and subject to full FSA regulation and relevant requirements in the same way as any other comparable firm, with some exceptions relating to compensation, client money, and lower PII and prudential requirements.¹ A firm will usually fall into this category either:
 - where it is carrying out regulated financial services business in a way that could not be regarded as ‘incidental’ to its main professional business, for example due to the scale of the activity compared to the firm’s professional services, or where it is held out as a separate service; and/or
 - its activities are not eligible to be treated as ‘exempt’² business and so exempt from the need for FSA authorisation. Typically, these firms may be giving investment advice (e.g. on products such as pensions and unit trusts) or undertaking discretionary investment management.

1 Firms that are regulated by the Law Society (England and Wales) and the Law Society of Scotland do not participate in the FSCS, and firms that are regulated by one of the three Law Societies (including Northern Ireland as well as the two above) are deemed to comply with the CASS client money rules for non-MiFID firms, if they comply with the rules of their society.

2 Part XX of FSMA provides an exemption from FSA authorisation in defined circumstances for certain incidental activities carried on by firms which are regulated by designated professional bodies designated under section 326 of FSMA.

Authorised for non-mainstream regulated activities

2. These firms are authorised, but are regulated under a modified/less intensive regime than other firms, as set out in PROF Chapter 5, because their activities meet the PROF 5 conditions for being authorised 'non-mainstream' activities. The main conditions for non-mainstream activities are:
 - they cannot be non-exempt activities (see above);
 - they are provided in a manner which is incidental to the provision of professional services;
 - they cannot give rise to the receipt from any person other than the client of a pecuniary reward or other advantage for which the professional does not account to his client; and
 - they must be subject to the rules made by the firm's designated professional body.

3. The effect is that, in respect of non-mainstream activities:
 - the Principles for Businesses still apply;
 - most of the conduct of business rules (COBS, ICOBS and MCOB) do not apply (some Financial Promotions rules do, and the Insurance Mediation Directive (IMD) rules must be satisfied either by complying with ICOBS or approved designated professional body rules);
 - Training & Competence requirements do not apply (so the designated professional body's competence, including ethical, requirements prevail);
 - the application of Senior Management Arrangements, Systems and Controls is modified in relation to anti-money laundering;
 - Approved Persons – only the required functions³ apply;
 - DISP 1, which covers complaints handling by firms, does not apply to an authorised professional firm 'in respect of expressions of dissatisfaction about its non-mainstream regulated activities';
 - CASS does not apply except in relation to Insurance Mediation Directive business and insurance client money (and even these do not apply if the designated professional body has rules applicable to the firm which implement the Insurance Mediation Directive and have been approved by FSA); and
 - FSMA s150 rights apply in respect of private persons who suffer a loss.

³ Any of controlled functions 8 to 12B in the table of controlled functions at SUP 10.4.5 R.

4. Our supervisory regime for authorised professional firms therefore covers prudential as well as conduct issues (e.g. capital, professional indemnity insurance, systems & controls). For example, the Interim Prudential Sourcebook for investment businesses applies, requiring authorised professional firms to hold adequate professional indemnity insurance for all the business activities they carry on, and requiring them to be able to meet their liabilities as they fall due.

Annex 3

List of questions

- Q1:** Do you have any comments on the equality and diversity impact of our proposals?
- Q2:** Do you agree with our preferred option?
- Q3:** Do you agree with our proposed rule changes?
- Q4:** Do you have any comments about the costs and benefits set out in Annex 1?

Appendix 1

Draft Handbook text

Appendix 1:

Draft Handbook text

PROFESSIONAL FIRMS (AMENDMENT) INSTRUMENT 2011

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of:
- (1) the powers and related provisions in the following sections of the Financial Services and Markets Act 2000 (“the Act”):
 - (a) section 138 (General rule-making power);
 - (b) section 156 (General supplementary powers); and
 - (c) section 157(1) (Guidance); and
 - (2) the other powers and related provisions listed in Schedule 4 (Powers exercised) to the General Provisions of the Handbook.
- B. The rule-making powers referred to above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on [1 October 2011].

Amendments to the Handbook

- D. The modules of the FSA’s Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

(1)	(2)
Glossary of definitions	Annex A
Client Assets sourcebook (CASS)	Annex B
Supervision manual (SUP)	Annex C
Professional Firms sourcebook (PROF)	Annex D

Citation

- E. This instrument may be cited as the Professional Firms (Amendment) Instrument 2011.

By order of the Board
[22 September 2011]

Annex A

Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text.

- participant firm* (1) (except in *FEES* 1 and, *FEES* 6) a *firm* or a *member* other than:
- ...
- (f) an *authorised professional firm* that is subject to the rules of the Law Society (England and Wales) or the Law Society of Scotland and with respect to its *regulated activities* participates in the relevant society's compensation scheme;
- ...
- ...
- professional firm* a *person* which is:
- (a) an individual who is entitled to practise a profession regulated by a *designated professional body* and, in practising it, is subject to its rules, whether or not he is a member of that body; or
- (b) a *person* (not being an individual) which is controlled ~~and~~ or managed by one or more such individuals.

Annex B

Amendments to the Client Assets sourcebook (CASS)

In this Annex, underlining indicates new text and striking through indicates deleted text.

5.1.3 R An *authorised professional firm* regulated by The Law Society (of England and Wales), The Law Society of Scotland or The Law Society of Northern Ireland ~~must comply with~~ that with respect to its *regulated activities* is subject to the rules of its *designated professional body* as specified in CASS 5.1.4R, in force on 14 January 2005, must comply with those rules and if it does so, it will be deemed to comply with CASS 5.2 to CASS 5.6.

...

7.1.15 R (1) An *authorised professional firm* regulated by the Law Society (of England and Wales), the Law Society of Scotland or the Law Society of Northern Ireland ~~must comply with~~ that with respect to its *regulated activities* is subject to the following rules of its *designated professional body*, must comply with those rules and, where relevant paragraph (3), and if it does so, it will be deemed to comply with the *client money rules*.

...

Annex C

Amendments to the Supervision manual (SUP)

In this Annex, underlining indicates new text and striking through indicates deleted text.

- 3.10.2 R An auditor of an *authorised professional firm* need not report under this section in relation to that *firm's* compliance with the *client money rules* in the *client money chapter* if:
- (1) that *firm* is regulated by:
 - ~~(1)~~(a) the Law Society (England and Wales); or
 - ~~(2)~~(b) the Law Society of Scotland; or
 - ~~(3)~~(c) the Law Society of Northern Ireland; and
 - (2) that *firm* is subject to the rules of its *designated professional body* as specified in CASS 7.1.15R(2), with respect to its *regulated activities*.

Annex D

Amendments to the Professional Firms sourcebook (PROF)

In this Annex, underlining indicates new text and striking through indicates deleted text.

2.1.5 G Section 327(2) provides that an *exempt professional firm* must be a *member* of a profession or be controlled or managed by one or more *members*. The FSA considers that “managed” here should be read with its natural meaning. However, it may not be sufficient for a compliance manager to fulfil the role of manager, unless that individual is also able to exercise significant management functions involving overall oversight of the operation/business of the relevant person.

...

5.1.4 G A “*non-mainstream regulated activity*” is defined in the *Glossary* as “a *regulated activity* of an *authorised professional firm* in relation to which the conditions in *PROF 5.2.1R* are satisfied”. Conditions (1) to ~~(5)~~(6) of *PROF 5.2.1R* replicate section 327(1)(b)(i), (3), (4), (5) and (6) of the *Act*, as if those conditions applied to an *authorised professional firm*.

...

5.2.1 R A “*non-mainstream regulated activity*” is a *regulated activity* of an *authorised professional firm* in relation to which the following conditions are satisfied:

... ..

(4) there must not be in force any direction under section 328 of the *Act* (Directions in relation to the general prohibition) in relation to:

(a) a class of *person* which would have included the *firm* were it not an *authorised firm*; or

(b) a description of *regulated activity* which includes the *regulated activity* the *firm* proposes to carry on; ~~and~~

(5) the *regulated activity* must be an activity which *exempt professional firms* which are *members* of the same *designated professional body* as the *authorised professional firm* are permitted to carry on under rules made by that body as required by section 332(3) of the *Act*; and

(6) the *authorised professional firm* is subject to the rules referred to in (5).

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