LAW ANGELS

# LEGAL SERVICES

SQE 1 PREP

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**LEGAL SERVICES**



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# PREFACE

The practice of law is a privilege that carries profound responsibility. A solicitor is not merely a technician of the law but a guardian of the rule of law, entrusted with clients' liberty, livelihoods, and families. This role is exercised within a sophisticated and demanding regulatory ecosystem, designed to protect the public and uphold the integrity of the profession. This textbook is designed to be your essential guide to this foundational framework, providing a clear and practical pathway through the rules, risks, and ethical duties that define the modern solicitor.

Our approach is built on a simple belief: to practise law effectively and ethically, you must understand not just what the rules are, but why they exist and how they apply in daily practice. We have therefore structured this text to do more than list regulatory obligations. It deconstructs the entire professional landscape, from the constitutional architecture of the *Legal Services Act 2007* to the frontline compliance duties in anti-money laundering and financial services. You will find a consistent focus on the SRA Principles as the ethical bedrock, the concept of risk-based regulation, and the practical application of complex rules in scenarios ranging from client due diligence to managing conflicts of interest.

The journey to becoming a solicitor requires a deep and application-based knowledge of professional conduct. This book is tailored to that challenge. We integrate pivotal cases, such as ***R v Duff*** on money laundering and ***Wingate v SRA*** on integrity, not as isolated facts, but as essential lessons in professional judgment. Clear examples, flowcharts for navigating Suspicious Activity Reports, and practical checklists are woven throughout to transform your understanding from passive reception to active risk management.

Our goal is to equip you with a formidable and practical command of your professional obligations. Whether you are assessing a client for money laundering risk, navigating the boundaries of the Exempt Professional Firm status, or upholding your duty to the court, the following pages will provide the clarity, ethical rigour, and analytical depth you need to succeed.

Welcome to the study of legal services regulation. Its principles are the foundation of your professional identity, and their mastery is indispensable for any competent and trusted solicitor.

*Law Angels*

# ACKNOWLEDGEMENTS

The development of this textbook was a significant endeavor, and we extend our sincere gratitude to the collective efforts that made this publication possible.

At Law Angels, we are fortunate to be supported by a dedicated team whose commitment to legal education and excellence is the cornerstone of our work. The collaborative spirit, legal expertise, and tireless effort of our entire organization were instrumental in shaping this text from concept to completion.

We also extend our appreciation to the broader legal community. The insightful feedback from our academic and practitioner reviewers greatly enhanced the accuracy and clarity of the material. Their contributions, offered in a spirit of scholarly collaboration, have been invaluable in ensuring this resource meets the rigorous demands of the SQE curriculum.

We are also thankful for the unwavering support from our personal networks, whose understanding provided the foundation that allowed this project to thrive.

It is our privilege at Law Angels to contribute to the education of future solicitors, and we hope this text serves as a reliable guide for the next generation of legal professionals.

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# GLOSSARY OF KEY TERMS

**A**

**After-the-Event (ATE) Insurance**: An insurance policy taken out *after* a dispute has arisen to cover the risk of having to pay the opponent's legal costs and the client's own disbursements if the case is lost.

**Alternative Business Structure** (ABS): A legal services provider that is owned or managed by non-lawyers, permitted under the Legal Services Act 2007 to encourage competition and innovation.

**Anti-Money Laundering** (AML): The set of laws, regulations, and procedures designed to prevent criminals from disguising illegally obtained funds as legitimate income.

**Approved Regulator**: A body, such as the SRA or the Bar Standards Board, approved by the Legal Services Board to regulate a specific legal profession.

**Authorised Disclosure**: A disclosure made to the National Crime Agency (NCA) regarding suspected money laundering, which can provide a statutory defence to the principal money laundering offences if made before the prohibited act and consent is sought.

**Authorised Person**: An individual or entity that is authorised by an Approved Regulator to carry on reserved legal activities.

**B**

**Before-the-Event (BTE) Insurance**: A pre-existing insurance policy, often an add-on to home or motor insurance, that covers the policyholder's potential legal costs for future disputes.

**Beneficial Owner**: The real, live individual who ultimately owns or controls a legal entity or client, and/or on whose behalf a transaction is being conducted.

**Business Relationship**: A professional relationship between a firm and a client, expected to have an element of duration.

**C**

**Client Account**: A bank account used by a firm to hold money for clients, separate from the firm's own money, as mandated by the SRA Accounts Rules.

**Conditional Fee Agreement** (CFA): A "no win, no fee" agreement where a client only pays their solicitor's fees if the case is successful. A success fee (an uplift on normal fees) may be payable by the client out of their damages in successful cases.

**Confidentiality**: The ethical and legal duty of a solicitor to keep their client's affairs secret, except in specific circumstances (e.g., where the law requires disclosure, as with AML reporting).

**Conveyancing**: The legal process of transferring property ownership from one person to another. It is a reserved instrument activity.

**Customer Due Diligence** (CDD): The process of identifying the client and verifying their identity, identifying the beneficial owner, and obtaining information on the purpose and intended nature of the business relationship. It is the foundation of AML compliance.

**D**

**Damages Based Agreement** (DBA): A type of contingency fee agreement where the solicitor's fee is an agreed percentage of the client's damages if the case is won. If the case is lost, the solicitor receives nothing.

**Defence Against Money Laundering** (DAML): The process of submitting a Suspicious Activity Report (SAR) to the NCA to seek "appropriate consent" to proceed with a transaction that would otherwise constitute a principal money laundering offence.

**Disbursements**: Payments made by a solicitor on behalf of a client to third parties, such as court fees or expert report fees.

**Disposable Income/Capital**: The amount of a client's income or capital that is calculated as available after certain deductions, used to determine financial eligibility for legal aid.

**E**

**Enhanced Due Diligence** (EDD): Enhanced CDD measures required in higher-risk situations, such as when dealing with Politically Exposed Persons (PEPs) or clients from high-risk third countries. It involves gathering additional information on the source of funds and wealth.

**Equality, Diversity and Inclusion** (EDI): The proactive duty of solicitors and firms to encourage a fair and inclusive profession, as required by SRA Principle 6.

**Exempt Professional Firm** (EPF): A firm, such as a solicitors' practice, that is permitted to carry on certain regulated financial activities without direct FCA authorisation, provided the activities are incidental to its legal services and other strict conditions are met.

**F**

**Financial Conduct Authority** (FCA): The conduct regulator for financial services firms in the UK, focusing on protecting consumers and ensuring market integrity.

**Financial Services and Markets Act 2000** (FSMA 2000): The primary UK legislation regulating the financial services industry.

**Firm-Wide Risk Assessment** (FWRA): A mandatory, documented assessment that a firm must undertake to identify and assess its exposure to money laundering risks.

**I**

**Independence**: The SRA Principle that a solicitor's professional judgement must be free from undue influence from the client, the firm, or third parties.

**Integrity**: A core SRA Principle, broader than honesty, encompassing being ethically sound, trustworthy, and straightforward.

**Interests of Justice Test**: The primary gateway for accessing criminal legal aid, which considers factors such as the risk of loss of liberty, case complexity, and the defendant's ability to understand proceedings.

**L**

**Legal Aid Agency** (LAA): The executive agency of the Ministry of Justice responsible for administering legal aid in England and Wales.

**Legal Ombudsman**: The independent body that resolves complaints about legal service providers, operated by the Office for Legal Complaints (OLC).

**Legal Services Board** (LSB): The independent oversight regulator for legal services in England and Wales, overseeing the frontline approved regulators.

**M**

**Means Test**: The financial eligibility assessment for civil legal aid, which examines a client's income and capital to determine if they qualify for public funding.

**Merits Test**: The assessment for civil legal aid that evaluates the strength of a case and whether it is a reasonable use of public funds, based on prospects of success and a cost-benefit analysis.

**Money Laundering Reporting Officer** (MLRO): The nominated officer in a firm responsible for receiving internal reports of suspicion and making external reports to the NCA.

**Money Laundering**: The process of disguising the criminal origin of money to make it appear legitimate.

**N**

**National Crime Agency** (NCA): The UK's lead agency for fighting organised crime; its Financial Intelligence Unit (FIU) is the recipient for all Suspicious Activity Reports (SARs).

## O

**Ongoing Monitoring**: The continuous process of scrutinising a business relationship to ensure transactions are consistent with the firm's knowledge of the client and to keep CDD information up-to-date.

## P

**Politically Exposed Person** (PEP): An individual entrusted with a prominent public function, their family members, or close associates, who present a higher money laundering risk due to their position.

**Principles** (SRA Principles): The ten fundamental, overarching ethical rules that underpin all aspects of a solicitor's practice and conduct.

**Proceeds of Crime Act 2002** (POCA): The primary UK legislation defining money laundering offences and establishing the confiscation regime for criminal property.

**Professional Indemnity Insurance** (PII): Compulsory insurance that law firms must hold to protect their clients from financial loss in the event of professional negligence.

## R

**Regulated Activity**: A specific financial activity, as defined in the Financial Services and Markets Act 2000 (Regulated Activities) Order, that requires FCA authorisation to carry on (e.g., advising on investments, arranging regulated mortgages).

**Reserved Legal Activities**: Specific legal activities, defined in the Legal Services Act 2007, that can only be carried out by individuals or firms authorised by an Approved Regulator. They include: the exercise of rights of audience, the conduct of litigation, reserved instrument activities, probate activities, notarial activities, and the administration of oaths.

**Risk-Based Regulation**: The SRA's approach to regulation, which focuses its resources on the areas and firms that present the greatest risk to the public and the public interest.

## S

**Scope of Legal Aid**: The specific categories of cases for which civil legal aid is available, as defined by the LASPO Act 2012. Cases not within scope cannot receive public funding.

**Solicitors Disciplinary Tribunal** (SDT): An independent statutory tribunal that hears and determines applications alleging misconduct against solicitors.

**Solicitors Regulation Authority** (SRA): The independent regulatory body for solicitors and law firms in England and Wales.

**Source of Funds** (SoF): The origin of the money used for a specific transaction.

**Source of Wealth** (SoW): The origin of a client's overall net worth.

**Specified Investment**: A type of financial product or asset (e.g., shares, insurance contracts, deposits) that falls within the UK's financial services regulatory perimeter.

**Suspicion in AML**: A state of mind that falls short of proof but is more than mere speculation; a "feeling of unease" based on objective facts that money laundering is occurring. It is the trigger for a reporting obligation.

**Suspicious Activity Report** (SAR): A report submitted to the NCA by a person in the regulated sector when they know, suspect, or have reasonable grounds to suspect that money laundering is taking place.

**T**

**Third-Party Funding** (Litigation Funding): An arrangement where a professional commercial funder, who is not a party to the dispute, agrees to finance some or all of a claimant's legal costs in return for an agreed share of the damages if the claim is successful.

# 1

# THE SOLICITORS' REGULATION AUTHORITY AND ITS ROLES

Imagine you want to build a house. Before you even pour the foundation, you need to know the rules: the building codes, the safety standards, and the boundaries of your land. Without these rules, houses could be unsafe, unstable, and infringe on others' property. The legal profession in England and Wales is similar. It is a powerful profession, entrusted with people's liberty, finances, and families. To ensure this power is used responsibly and for the public good, a robust framework of rules is essential.

This chapter introduces you to the architects and guardians of that framework. We will explore the landmark *Legal Services Act 2007*, which redesigned the entire legal landscape. We will then meet the primary regulator for solicitors, the Solicitors Regulation Authority (SRA), and understand its core mission. We will delve into the SRA Principles, the ten golden rules that underpin everything a solicitor does. Finally, we will unpack the modern approach of risk-based regulation and provide an overview of the key rulebooks that govern your professional life. Understanding this regulatory architecture is the first and most critical step in your journey to becoming a solicitor.

## 1.1 Introduction to the *Legal Services Act 2007* and the Regulatory Landscape

Prior to 2007, the regulation of legal professionals in England and Wales was often described as complex, outdated, and self-serving. Different professions (solicitors, barristers, legal executives, etc.) were largely regulated by their own representative bodies. This led to criticisms of a closed shop, with insufficient independent oversight and a focus on the interests of the professions rather than those of the public and consumers of legal services.

The *Legal Services Act 2007* (LSa 2007) was a revolutionary piece of legislation passed to modernise this system. Its primary purpose was to create a new, independent oversight structure and to open up the market for legal services to encourage competition and innovation, all while maintaining the core professional principles of justice and the rule of law.

Think of the *LSa 2007* as the constitution for the legal world. It established a new governmental structure with three key tiers:

1. **The Legal Services Board (LSB)**: This is the independent oversight regulator, often described as the "super-regulator." It sits at the top of the structure. Its job is to oversee all the frontline regulators (like the SRA and the Bar Standards Board) to ensure they are acting in the public interest and complying with the LSa 2007. It sets the high-level standards but does not regulate individual lawyers directly.

2. **The Approved Regulators (e.g., the SRA)**: These are the bodies, like the Law Society through its SRA, that are approved by the LSB to carry out the day-to-day regulation of specific legal professions. The SRA is the approved regulator for solicitors and law firms in England and Wales.

3. **The Office for Legal Complaints (OLC)**: This body runs the Legal Ombudsman scheme. Its role is to provide a free, independent service for resolving complaints about legal service providers that have not been settled by the firms themselves. This is a crucial consumer protection mechanism separate from the regulators.

Furthermore, the *LSa 2007* introduced new business structures to promote competition.

**Alternative Business Structures (ABS)**: These allow non-lawyers to own and manage law firms. This means supermarkets, banks, or other companies can own legal service providers. The aim was to encourage new investment and different ways of providing services to clients. However, any ABS providing reserved legal activities must be regulated by an approved regulator, like the SRA.

In essence, the *LSa 2007* moved the system from one of professional self-interest to one of independent oversight and consumer focus, with the SRA operating as the key frontline regulator for solicitors within this new ecosystem.

## 1.2 The Role and Function of the SRA

The Solicitors Regulation Authority is the independent regulatory arm of the Law Society of England and Wales. It is crucial to distinguish between the two:

The Law Society is the representative body for solicitors. It acts as a trade union, promoting the profession, offering training and support, and lobbying the government on behalf of its members. On the other hand, the SRA is the regulator. Its duty is not to promote solicitors but to protect the public and the public interest. This includes protecting consumers, supporting the rule of law, and promoting competition in the legal services market.

The SRA's functions are extensive and can be summarised as follows:

1. **Setting and maintaining standards**: The SRA writes the rulebooks that govern solicitors and firms, including the SRA Principles, Codes of Conduct, and Authorisation Regulations.

2. **Authorising and registering**: The SRA decides who can become a solicitor (by approving qualifications) and which entities can practise as law firms. It maintains the public roll of solicitors and the register of firms.

3. **Monitoring and supervision**: The SRA monitors the profession for compliance with its rules. This can involve requesting information, conducting audits, and visiting firms.

4. **Enforcing the rules**: When rules are broken, the SRA has the power to investigate and take action. This action can range from issuing a warning or a fine to restricting a solicitor's practising certificate, and in the most serious cases, referring a solicitor to the Solicitors Disciplinary Tribunal (SDT) who can strike them off the roll, preventing them from practising.

5. **Operational independence**: While it is part of the Law Society group, the SRA operates independently in its regulatory decisions. This "structural separation" is a key requirement of the *LSa 2007* to prevent any conflict of interest between representation and regulation.

## 1.3 The SRA Principles: The Foundation of Professional Conduct

At the very heart of the SRA's regulatory framework are the SRA Principles. These are not detailed, technical rules, but ten fundamental, overarching obligations that apply to all solicitors and all regulated law firms. They are the "spirit" of the rulebook. You must always abide by the *Principles*, even if you are technically complying with a more specific rule. If a specific rule does not cover a situation, you must revert to the *Principles* for guidance. They are the ethical bedrock of the profession.

The SRA Principles are as follows:

1. You act in a way that upholds the constitutional principle of the rule of law and the proper administration of justice. This is the most fundamental principle. The legal system cannot function without independent lawyers who ensure the law is applied fairly and justly. For example, you must not mislead the court, even if it would help your client.

   In ***Myers v Elman*** [1940] AC 282, a solicitor was held liable for costs because he failed to provide the court with full and frank disclosure, thereby obstructing the administration of justice.

2. You act in a way that upholds public trust and confidence in the solicitors' profession and in legal services provided by authorised persons. Your duty is to maintain the reputation of the profession as a whole. Behaviour that might seem minor in another context can breach this principle if it damages public trust.

   A solicitor was struck off for using racially abusive language in a public street, even though the incident was unrelated to his practice. The SDT found that such conduct inevitably undermined public trust in the profession.

3. You act with independence. Your professional judgement must be free from undue influence, whether from your client, your own financial interests, or a third party paying your fees.

   If a large corporate client pressures you to give advice that you know is legally weak, you must resist that pressure and provide your independent, honest opinion

4. You act with honesty. This needs little explanation but is absolute. Dishonesty, even in small matters, is almost always career-ending for a solicitor.

5. You act with integrity. This is broader than honesty. Integrity means being ethically sound, trustworthy, and straightforward. It is about doing the right thing, even when no one is watching.

   In ***Wingate v SRA*** [2018] EWCA Civ 366, the court described integrity as "the quality of having strong moral principles, probity, honesty, decency, fairness and trustworthiness." A solicitor might act dishonestly by deliberately lying, but they could lack integrity by taking unfair advantage of a vulnerable client, even without an outright lie.

6. You encourage equality, diversity and inclusion. This is a proactive duty. You must not only avoid discrimination but actively promote a fair and inclusive profession and provide services that meet the needs of diverse clients.

7. You act in the best interests of each client. This is the core of the solicitor-client relationship. You must always put your client's legitimate interests ahead of your own. This includes providing a competent service, keeping their affairs confidential, and avoiding conflicts of interest.

The remaining three principles apply specifically to those you manage or supervise within a firm:

8. You comply with your legal and regulatory obligations and deal with your regulators and ombudsmen in an open, timely and co-operative manner. You cannot hide from

the SRA or the Legal Ombudsman. If they ask questions, you must respond fully and promptly.

9. You run your business or carry out your role in the business effectively and in accordance with proper governance and sound financial and risk management principles. This is about having proper systems and controls in place, such as for handling client money, managing risk, and overseeing the firm.

10. You protect client money and assets. This is a sacrosanct duty. Client money must be kept separately from the firm's money in a designated client account and used only for the client's purposes. Breaches of the accounts rules are treated with the utmost seriousness.

These Principles are non-negotiable. They are the lens through which all your professional conduct will be judged.

## 1.4 Understanding Risk-Based Regulation

The traditional approach to regulation was often "checklist" based, where regulators would tick boxes to ensure every single rule was being followed, regardless of the risk involved. The SRA has moved to a more modern approach known as risk-based regulation.

Think of it like a hospital emergency room. Nurses don't treat patients in the order they arrive; they triage them. They assess each patient to see who is most at risk of dying or suffering serious harm and prioritise them. The SRA does the same with the thousands of law firms and solicitors it regulates. It does not have the resources to constantly check everyone, so it focuses its attention where the risk to the public and the public interest is greatest.

The SRA's approach is based on asking a series of questions:

- What is the risk? (e.g., risk to clients, risk to the rule of law).
- Where is the risk? (e.g., in which types of practice, in which firms?).
- How serious is the risk?
- How can we best target our resources to manage that risk?

**Examples of Higher-Risk Scenarios**

- A firm handling large amounts of client money in complex property transactions.
- A firm with a single owner-manager and weak internal systems (poor governance).
- A solicitor with a history of regulatory breaches.
- A new, unproven firm operating as an Alternative Business Structure (ABS).
- A firm specialising in areas prone to money laundering, like conveyancing.

**Examples of Lower-Risk Scenarios**

- A large, well-established firm with strong internal compliance teams and audited systems.
- An in-house solicitor working for a local authority, not holding client money.
- A firm doing low-volume, non-contentious work like drafting wills.

For you, as an aspiring solicitor, this means that the SRA expects your firm to have its own effective systems for identifying and managing risk. The regulator will not micromanage you, but it will hold you accountable for the outcomes. If something goes wrong, the SRA will want to know not just what happened, but why your firm's risk management processes failed to prevent it.

## 1.5 The SRA Standards and Regulations: An Overview

The SRA Principles are given practical effect through a detailed set of rules and regulations. The main components of the SRA's handbook are:

**SRA Code of Conduct for Solicitors, RELs and RFLs**: This sets out the standards of professional conduct expected of individual solicitors, registered European lawyers (RELs) and registered foreign lawyers (RFLs). It is divided into sections on:

- Section 1: You and your client (e.g., confidentiality, conflicts, competence).
- Section 2: You and your business (e.g., effective business management, cooperation with regulators).
- Section 3: You and your regulator (e.g., reporting serious misconduct).

- Section 4: You and others (e.g., relations with third parties).
- Section 5: You and your profession (e.g., public respect for the profession).

**SRA Code of Conduct for Firms**: This sets out the standards expected of the entities we call "firms." It mirrors many of the obligations in the individual code but applies them at an organisational level (e.g., ensuring the firm has effective systems and controls).

**SRA Authorisation of Firms Regulations**: These are the rules that govern how to become and remain an authorised firm. They cover the requirements for obtaining and maintaining authorisation, including the duties of managers and compliance officers.

**SRA Accounts Rules**: These are the detailed, technical rules for handling client money. They are among the most important rules you will learn. They mandate, for example, that client money must be kept in a client account at a bank, that it must be returned to the client promptly when due, and that strict records must be kept. A breach of the Accounts Rules is one of the most common reasons for solicitors facing disciplinary action.

**SRA Compulsory Professional Indemnity Insurance Rules**: These require all authorised firms to take out insurance to protect their clients in case of negligence. This is a key consumer protection measure.

Understanding this structure is vital. The *Principles* are your moral compass. The Codes of Conduct are your guidebooks for daily behaviour. The Authorisation and Accounts Rules are the specific, technical requirements for practising. Together, they form the comprehensive rulebook that ensures solicitors serve their clients, the courts, and the public with competence, integrity, and independence.

## 1.6 Conclusion

In conclusion, the Solicitors Regulation Authority (SRA) stands at the heart of the modern legal regulatory framework in England and Wales, embodying the shift from self-interest to public accountability ushered in by the *Legal Services Act 2007*. It serves not merely as an enforcer of professional discipline but as the guardian of public trust, ensuring that solicitors uphold the rule of law, act with integrity, and deliver services in a fair and competent manner.

By setting and maintaining professional standards, authorising practitioners, and holding them accountable through enforcement where necessary, the SRA sustains the delicate balance between professional autonomy and public protection upon which confidence in the legal system depends.

Ultimately, understanding the SRA's principles and regulatory mechanisms is essential for any aspiring solicitor. They provide the ethical and structural foundation upon which all professional conduct is judged. The ten SRA Principles, together with the Codes of Conduct and associated regulations, form a cohesive framework that demands both technical compliance and moral responsibility. Whether in practice or in personal life, a solicitor's conduct reflects upon the profession as a whole. Upholding these standards is not only a legal duty but also a moral commitment to preserving justice, integrity, and trust, the cornerstones of the profession.

# 2

# RESERVED AND REGULATED LEGAL SERVICES

Imagine a world where anyone could perform surgery, regardless of training. Or where anyone could call themselves an architect and design a skyscraper. The potential for harm would be enormous. Certain tasks are so important, and require such a high level of skill and ethics, that the law restricts who can perform them. The legal profession is no different. While many people can offer general legal advice, there are specific, high-stakes legal tasks that are so crucial to the administration of justice and the protection of the public that they are legally "reserved" for qualified, regulated, and insured professionals.

This chapter explores the concept of "Reserved Legal Activities," the six specific tasks that fall into this category, and the strict rules governing who can perform them. We will also meet the other legal professionals who are authorised to undertake these activities and, finally, examine the serious consequences for those who step over the line and practise illegally. Understanding these boundaries is fundamental to knowing what it means to be a solicitor and how the legal services market is structured to protect you and your future clients.

## 2.1 The Concept of Reserved Legal Activities

At its core, the concept of a Reserved Legal Activity is about public protection. The state, through the *Legal Services Act 2007*, has decided that certain legal functions are too important to be left to unqualified individuals. These activities often involve:

- A significant risk to the client's rights, liberty, or financial security.

- A direct impact on the operation of the courts and the proper administration of justice.
- The need for a high degree of specialised legal knowledge and ethical training.

The reservation of these activities creates a "protected space." Only individuals or entities that are authorised by an Approved Regulator, such as the SRA, the Bar Standards Board (BSB), or CILEx Regulation, are permitted to carry them out. To become authorised, a professional must meet stringent requirements regarding their education, training, character, and competence. They must also adhere to a strict code of conduct, hold professional indemnity insurance, and be subject to an independent complaints system.

This system is not designed to create a monopoly for solicitors. Instead, it is designed to ensure that when a member of the public needs help with a critical legal matter, they can be confident that the person helping them is properly qualified, insured, and accountable. It is a quality mark. When you see a solicitor providing advocacy in court, you know they have met the high standards set by the SRA. This protects clients from unqualified 'cowboys' who could cause serious, irreversible harm through their incompetence or dishonesty.

## 2.2 The Six Reserved Activities

The *Legal Services Act 2007* specifically lists six Reserved Legal Activities. It is a criminal offence for a person who is not entitled to perform any of these activities, and doing so may also amount to a civil wrong (a tort). For solicitors, their ability to conduct these activities is a key part of their professional identity and value.

The six activities are:

1. **The Exercise of Rights of Audience**

   This is the right to appear before and address a court or tribunal. It includes presenting a case, examining witnesses, and making legal arguments on behalf of a client. It is reserved because it directly affects the court's ability to discover the truth and administer justice fairly.

   **What it includes**: Addressing a judge in the High Court, making a plea in mitigation in a magistrates' court, cross-examining a witness in a tribunal.

**What it does not include**: Simply sitting next to a client in court as a moral supporter, or representing a client at a non-statutory public inquiry.

### 2. The Conduct of Litigation

This is much broader than just advocacy. It encompasses the entire process of managing a case through the court system. This includes issuing claim forms, serving documents, filing evidence, and complying with court orders and procedures. It is reserved because mismanaging litigation can lead to a client losing their case on a technicality, incurring unnecessary costs, or being in contempt of court.

**What it includes**: Drafting and issuing a claim form for a personal injury case, preparing a bundle of documents for trial, applying to the court for an extension of time.

**What it does not include**: A McKenzie Friend (a layperson who assists a litigant in person) providing quiet advice and taking notes in court, provided they do not act as an advocate or manage the case.

### 3. Reserved Instrument Activities

This is a technical term that refers, in practice, to the core work of conducting a conveyancing transaction for the transfer of land or property. It involves preparing the legal documents needed to transfer ownership (such as the transfer deed) and dealing with the Land Registry. It is reserved because errors in property transactions can have devastating financial consequences for individuals and families.

**What it includes**: Preparing the transfer deed for a house sale, submitting an application to the Land Registry to record a new owner.

**What it does not include**: An estate agent drafting a simple sale agreement, or a person selling their own house without legal help (as they are not acting for another).

### 4. Probate Activities

This relates to applying for the legal right to deal with the estate (the money, property, and possessions) of someone who has died. This is known as obtaining a "grant of representation" (which includes a grant of probate). While anyone can apply for probate themselves, the activity of preparing the necessary documents for a grant for another person, for a fee, is a reserved activity. It is reserved because it involves handling sensitive and valuable assets for vulnerable grieving people, and mistakes or dishonesty can lead to significant loss.

**What it includes**: Preparing the oath and other documents required to apply for a grant of probate on behalf of an executor.

**What it does not include**: A bank, as an executor named in a will, applying for probate for an estate it is appointed to administer.

### 5. Notarial Activities

The work of a notary public involves authenticating and certifying signatures, documents, and transactions for use in other countries. It is a reserved activity because notarial acts carry immense international legal weight and are relied upon by foreign governments and businesses.

**What it includes**: Witnessing a power of attorney for use abroad, certifying a copy of a passport, preparing a ship's protest.

**Note**: Most notaries in England and Wales are also solicitors, but they require a separate notarial qualification and are regulated by the Faculty Office of the Archbishop of Canterbury.

### 6. The Administration of Oaths

This is the act of witnessing the swearing of an oath or the making of a solemn affirmation, typically on a legal document like a witness statement or an affidavit. It is reserved to ensure that the process is carried out with due formality and to deter people from making false statements on sworn documents.

**What it includes**: A solicitor in their office, witnessing a client swear on a bible that the contents of their affidavit are true.

Commissioners for Oaths and Notaries Public can also perform this function.

## 2.3 Who Can Undertake Reserved Activities?

The *Legal Services Act 2007* creates a flexible system where different types of legal professionals can be authorised to perform reserved activities. Authorisation comes from an "Approved Regulator." The key authorised persons are:

**Solicitors**: Solicitors are authorised by the SRA to conduct all six reserved activities, provided they hold a valid practising certificate and are compliant with SRA regulations. This "full-service" authorisation is a defining feature of the solicitor's profession.

**Barristers**: Barristers are authorised by the Bar Standards Board (BSB). They have full rights of audience in all courts and can conduct litigation. Their traditional focus has been on advocacy, but they can now also be authorised to conduct litigation directly.

**Chartered legal executives**: Fellows of the Chartered Institute of Legal Executives (CILEx) are authorised by CILEx Regulation. They can gain rights to conduct litigation and exercise rights of audience in certain courts, as well as undertake probate and reserved instrument activities, depending on their specific qualifications and practice rights.

**Licensed conveyancers**: Regulated by the Council for Licensed Conveyancers (CLC), they are specifically trained and authorised to carry out reserved instrument activities (conveyancing) and probate activities.

**Patented attorneys and trade mark attorneys**: Regulated by their own bodies, they have limited rights of audience and litigation rights in specific intellectual property proceedings.

**Other regulated persons**: Notaries Public (for notarial activities) and Commissioners for Oaths (for administering oaths) are authorised for their specific reserved activities.

Crucially, the authorisation extends to the entities for which these individuals work. An SRA-regulated law firm is itself authorised to undertake reserved activities through its employed solicitors and other authorised staff. This is why a client can instruct "the firm," and the firm is liable for the actions of its employees.

## 2.4 Other Regulated Providers of Legal Services

The legal services market is diverse, and solicitors are not the only players. It is important to recognise other regulated professionals who provide legal services, often in specialised areas. This promotes competition and gives consumers choice, while still ensuring public protection.

**Chartered legal executives (CILEx)**: As mentioned, CILEx Fellows are highly qualified lawyers who specialise in a particular area of law, such as litigation, conveyancing, or family law. They often have a more vocational training route than solicitors and are a vital part of many legal teams.

**Licensed conveyancers**: These are specialists in property law. They undergo specific training focused on conveyancing and probate, and they are regulated by the CLC. A client buying a house can choose to use a firm of solicitors or a firm of licensed conveyancers.

**Paralegals**: It is critical to note that the term "paralegal" is not a protected title. Anyone can call themselves a paralegal. However, many paralegals are highly skilled and work under the supervision of an authorised person, like a solicitor. They can perform a vast amount of legal work, but they cannot perform a reserved activity unless it is delegated to them in a way that remains under the direct supervision and responsibility of an authorised person. For example, a paralegal can draft documents for a conveyancing transaction, but the supervising solicitor must check and approve them before they are used.

This ecosystem of regulated providers means that the public has access to a range of qualified professionals. The choice between a solicitor, a chartered legal executive, or a licensed conveyancer may depend on the complexity of the matter, the client's personal preference, and cost.

## 2.5 The Implications of Unauthorised Practice

The strict rules around reserved activities are backed by serious consequences for those who break them. The law treats unauthorised practice very seriously to deter "rogue" advisors and protect the public.

The implications can be both criminal and civil:

**Criminal Liability**

Under *s.14* of the *Legal Services Act 2007*, it is a summary offence for a person to pretend to be, or to do anything that implies they are, a person entitled to carry on a reserved legal activity when they are not. If convicted in a magistrates' court, a person can be fined. While not punishable by imprisonment, a criminal conviction can have a severe impact on a person's career and reputation.

For example, an unqualified person who sets up a website offering "probate services" and prepares probate documents for clients would be committing a criminal offence.

**Civil Consequences**

**Unenforceability of fees**: Perhaps the most significant civil consequence is found in *s.18* of the *Legal Services Act 2007*. If an unqualified person provides a reserved legal activity, they are not entitled to be paid any fees for that work. A court cannot enforce a payment for those services. This is a powerful financial deterrent.

**Professional misconduct**: For a solicitor, allowing an unqualified person like a paralegal or a trainee to perform a reserved activity without the proper level of supervision would itself be a serious breach of the SRA Principles and Code of Conduct, leading to disciplinary action against the solicitor.

**Negligence and lack of insurance**: An unqualified person will not have the compulsory professional indemnity insurance that regulated lawyers must hold. If they make a mistake, the client may have no way to recover their losses, even if they sue for negligence. The unqualified person may not have the assets to pay any judgment.

***PJ Kirby & Co v R E L Products Ltd*** [1989] 5 BCC 18 provides a classic illustration of the common law principle that predated the *2007 Act*. In this case, an unincorporated firm (which was not entitled to conduct litigation) issued proceedings on behalf of a client. The court held that the proceedings were a nullity because they had been issued by a person without the right to do so. This highlights the catastrophic consequences for the client – their entire case can be thrown out due to the unauthorised status of their representative.

## 2.6 Conclusion

The system of reserved legal activities creates a vital protective ring around the public. As a future solicitor, your authorisation to practise these activities is a privilege that carries immense responsibility. It is your duty to understand these boundaries, to work within them, and to ensure that the trust the public places in the profession is always well-founded.

# 3

# CORE REGULATORY OBLIGATIONS

A solicitor's duties extend far beyond simply knowing the law and representing their clients. They operate within a complex web of obligations designed to protect clients, uphold the justice system, and maintain public trust. This chapter explores three of the most critical pillars supporting this structure of responsibility. First, we will examine Professional Indemnity Insurance (PII), the essential financial safety net that ensures a client is protected even if a solicitor makes a mistake.

Second, we will unravel the concept of 'Overriding Legal Obligations', the crucial hierarchy that dictates what happens when professional rules and the law conflict. Finally, we will delve into the practical application of the *Equality Act 2010*, moving beyond the textbook to understand how a solicitor must actively foster fairness, prohibit discrimination, and make their services accessible to all. These obligations are not optional extras; they are fundamental to the identity and integrity of the modern legal profession.

## 3.1 Professional Indemnity Insurance (PII): Purpose and Minimum Requirements

Imagine you hire a builder to build an extension on your house. Halfway through, a wall collapses because the builder made a serious error. If the builder has no insurance, you may never recover the money you lost. The same principle applies to legal services. The work solicitors do often involves clients' most important assets: their liberty, their children, their homes, and their life savings. The stakes are incredibly high. Even the most competent and careful solicitor can, on occasion, make a mistake, a missed deadline, an error in a document, or flawed advice. The purpose of Professional Indemnity Insurance (PII) is to ensure that if such a mistake causes a client financial loss, the client will be compensated, even if the firm itself does not have the money to pay.

PII is therefore not just a good idea; it is a compulsory regulatory requirement. The SRA mandates that every authorised law firm must have a policy in place that meets its minimum terms and conditions. This is a key component of public protection. It gives clients the confidence to instruct solicitors, knowing they are financially protected.

The SRA's minimum requirements for PII are designed to be robust. Key features include:

1. **Minimum level of cover**: Firms must be insured for at least £2 million for each claim, and the policy must cover all the work done by the firm. For many firms, especially those handling large commercial transactions or litigation, the level of cover will be much higher, but £2 million is the compulsory floor.

2. **'Civil liability' cover**: The policy must cover any civil liability (like a claim for negligence) arising from the firm's activities anywhere in the world. This is broad coverage, ensuring that almost any error that leads to a financial loss for a client is covered.

3. **Run-off cover**: This is a vital feature. What happens if a firm closes down? A client might only discover a mistake years later. The SRA rules require firms to arrange and pay for 'run-off cover', which insures them for claims made after they have stopped practising, typically for a period of six years.

4. **Claims-made basis**: PII operates on a 'claims-made' basis. This means the policy that responds is the one in place when the claim is made against the firm, not when the mistake was actually made. This is why it is crucial for firms to maintain continuous, uninterrupted coverage.

The consequences of not having compliant PII are severe. The SRA can suspend a firm's authorisation, effectively shutting it down. Furthermore, if a firm practises without insurance and a client suffers a loss, the firm's managers may be held personally liable. For a client, the simple question "Are you insured?" is one of the most important they can ask.

***Dean v Allin & Watts*** [2001] EWCA Civ 758 is a stark reminder of the dangers of operating outside the safety of PII and proper authorisation. In this case, a firm that was not properly authorised to conduct litigation attempted to secure a charge over a client's property as security for costs. The transaction was found to be unenforceable. The case highlights the chaos and financial loss that can occur when firms (or individuals) operate without the proper regulatory safeguards, including PII, in place.

## 3.2 Overriding Legal Obligations: The Hierarchy of Compliance

As a solicitor, you are subject to many different sets of rules: the SRA Principles and Code of Conduct, the rules of the court, and the general law of the land. But what happens when these rules conflict? The *SRA Principles* provide a clear and unequivocal answer.

*Principle 1.1* states: "You obey your legal and regulatory obligations and take account of the law and the public interest."

This establishes a clear hierarchy of compliance. Your duty to comply with the law overrides every other professional duty. If a client asks you to do something that is legal but might be considered sharp practice, your professional rules may forbid it. However, if a client asks you to do something that is illegal, your professional duty is clear: you must refuse.

This hierarchy can create difficult ethical dilemmas. For example, the duty of confidentiality to a client is a core professional obligation (*Principle 7*). However, this duty is not absolute. It is overridden by the legal duty to comply with anti-money laundering legislation, which requires you to report suspicious transactions to the National Crime Agency. In this situation, the law trumps the professional rule of confidentiality.

Another critical example is the duty to the court, which is enshrined in *Principle 1*: "You act in a way that upholds the constitutional principle of the rule of law and the proper administration of justice." This duty overrides your duty to your client. You cannot, under any circumstances, mislead the court. If your client tells you they are guilty but insists on pleading not guilty, you cannot allow the court to be misled. Your obligation would be to cease acting for that client if they persisted in this course of action.

***R (on the application of Prudential plc) v Special Commissioner of Income Tax*** [2013] UKSC 1, while primarily about legal advice privilege, reinforces the principle that solicitors operate within the framework of law. The Supreme Court emphasised that privileges and professional duties are defined and constrained by the law, and cannot be extended beyond their legal limits by the profession itself. This underscores that the law is the ultimate authority.

In practical terms, this means a solicitor must constantly be asking: "Is what I am being asked to do lawful?" If the answer is no, then the professional rules provide no defence. Upholding the law is your primary regulatory duty.

## 3.3 The *Equality Act 2010* in Legal Practice

The legal profession is a cornerstone of a just society, tasked with upholding the rule of law and providing access to justice. It would represent a fundamental betrayal of this role if access to legal services or fairness within the profession were compromised by a person's background, identity, or personal characteristics. The *Equality Act 2010* (the Act) is therefore not merely a piece of legislation about which solicitors advise their clients; it is a framework that must be deeply embedded in the very fabric of their professional conduct.

The Solicitors Regulation Authority (SRA) has elevated this legal obligation to a core ethical tenet through *Principle 6*: "You encourage equality, diversity and inclusion." This transforms a passive duty to avoid discrimination into a positive, proactive professional duty to actively foster fairness. This section will expound upon the types of prohibited conduct, the crucial duty to make reasonable adjustments, and the practical steps required to promote equality, diversity, and inclusion within a legal practice.

### 3.3.1 The Protected Characteristics and the Scope of Protection

The Act provides protection from discrimination, harassment, and victimisation across nine specific protected characteristics:

1. **Age**: This refers to a person belonging to a particular age group (e.g., 21-30, over 50).
2. **Disability**: A physical or mental impairment which has a 'substantial' and 'long-term' adverse effect on a person's ability to carry out normal day-to-day activities. This includes conditions such as cancer, HIV, and long-term mental health conditions.
3. **Gender reassignment**: The process of transitioning to a different gender. A person does not need to be undergoing medical treatment to be protected.
4. **Marriage and civil partnership**: The protection covers being married or in a civil partnership. Notably, it does not protect single people.
5. **Pregnancy and maternity**: Protection against discrimination because of pregnancy, or because of an illness suffered as a result of pregnancy, or because of maternity leave.
6. **Race**: This encompasses colour, nationality, and ethnic or national origins.
7. **Religion or belief**: This includes any religion (e.g., Christianity, Islam, Judaism) or lack of religion, as well as philosophical beliefs such as humanism or atheism. The belief must be genuinely held and affect a person's way of life.
8. **Sex**: Being a man or a woman.
9. **Sexual orientation**: A person's sexual orientation towards persons of the same sex (gay/lesbian), the opposite sex (heterosexual), or both sexes (bisexual).

In the context of a law firm, the Act applies to three key relationships:

1. **As an employer**: Governing how the firm treats its partners, employees, and job applicants.
2. **As a service provider**: Governing how the firm treats its clients and potential clients.
3. **As a manager of premises**: Governing access to the firm's offices and facilities.

### 3.3.2 A Deeper Look at Prohibited Conduct

Understanding the nuances of each type of prohibited conduct is essential for compliance.

### Direct Discrimination

This occurs when someone is treated less favourably because of a protected characteristic. The less favourable treatment must be a consequence of the characteristic itself.

### Examples

- A senior partner reviews two equally qualified CVs for a trainee solicitor position. One candidate is named David, aged 24; the other is named Margaret, aged 58. The partner says, "Margaret is too old to fit in with our firm's culture," and discards her application. This is direct discrimination on the grounds of age.
- A firm has a policy of not accepting instructions from clients who wish to make a claim under a Sharia finance agreement, based on a negative assumption about the clients' beliefs. This could constitute direct discrimination on the grounds of religion.

***James v Eastleigh Borough Council*** [1990] 2 AC 751 is a classic illustration. The council gave free swimming to people of state pension age. A 61-year-old man was given free swimming, but his 60-year-old wife was not. As the state pension age was different for men and women at the time, this was direct discrimination on the grounds of sex, as the treatment was based solely on the criterion of sex.

### Indirect Discrimination

This is often more subtle but equally unlawful. It occurs when a firm applies a Provision, Criterion or Practice (PCP) to everyone, but that PCP puts people with a particular protected characteristic at a particular disadvantage, and the firm cannot show it to be a proportionate means of achieving a legitimate aim.

### Breaking it Down

**PCP**: A rule or policy. E.g., "All solicitors must work full-time."

**Particular disadvantage**: This PCP puts women at a disadvantage because they are statistically more likely to have caring responsibilities preventing full-time work.

**Legitimate aim**: A real business need. E.g., "We need to ensure adequate client cover."

**Proportionate**: Is the PCP an appropriate and necessary way to achieve the aim? Could the aim be met by a less discriminatory measure? E.g., offering flexible job-shares or part-time partnerships.

**Example**: A firm requires all staff to work from the office between 9 am and 5:30 pm. A disabled employee with chronic fatigue syndrome finds the commute exhausting and requests to work from home two days a week. The firm refuses, citing a blanket policy. This PCP (mandatory office attendance) places the disabled employee at a disadvantage. The firm must demonstrate that its refusal is a proportionate means of achieving a legitimate aim (e.g., team collaboration), and would need to consider whether that aim could be met with the requested adjustment.

***Essop v Home Office (UK Border Agency)*** [2017] UKSC 27 clarified that for indirect discrimination, claimants do not need to prove why a PCP causes a disadvantage, only that it does in fact disproportionately affect their group. This makes it easier to bring claims where the reasons for the disparity are unclear or complex.

### Harassment

Harassment is defined as unwanted conduct related to a protected characteristic that has the purpose or effect of violating a person's dignity, or creating an intimidating, hostile, degrading, humiliating or offensive environment for them. The key point is that it is the *impact* on the victim that matters, not the intention of the perpetrator.

### Examples

- A senior solicitor repeatedly makes "banter" about a junior colleague's northern accent, mocking their pronunciation in front of others. Even if intended as a joke, if it creates an offensive environment for the junior colleague, it could constitute harassment related to race (national origins).
- A partner displays pictures of topless women on his office wall. A female trainee finds this creates a degrading and intimidating environment for her. This is likely to be harassment related to sex.

***Richmond Pharmacology v Dhaliwal*** [2009] IRLR 336 established that a single incident can amount to harassment. In this case, a remark that was "racist in tone" made on one occasion was sufficient to constitute harassment. The Employment Appeal Tribunal stated that harassment is about whether the conduct was "unwanted" and whether it had the proscribed effect on the victim.

**Victimisation**

This protects individuals who have taken, or are suspected of taking, action under the Equality Act. It occurs when someone is subjected to a detriment because they have done a 'protected act', such as:

- Bringing a discrimination claim.
- Giving evidence or information in connection with a claim.
- Making an allegation that someone has breached the Act.
- Raising a grievance about discrimination.

**Example**: A legal secretary supports a colleague's sexual harassment claim by giving a statement. After the case is concluded, she is overlooked for promotion, despite being the best candidate. The partner making the decision states, "We don't need troublemakers in management." This is victimisation.

### 3.3.3 The Duty to Make Reasonable Adjustments: An Anticipatory and Continuous Duty

This duty, found in *s.20* of the Act, is owed to disabled people and is one of the most important and proactive obligations for solicitors. The duty is anticipatory, meaning firms must think in advance about the barriers that might exist for disabled people and what adjustments could remove them. You cannot wait for a disabled client to walk through the door before considering accessibility.

The duty arises where a provision, criterion or practice, or a physical feature of premises, places a disabled person at a "substantial disadvantage" compared to a non-disabled person. The firm must then take such steps as it is reasonable to take to avoid that disadvantage.

What is 'Reasonable'?

This is not defined in the Act and is a question of fact and degree. Factors include:

- The effectiveness of the adjustment in preventing the disadvantage.
- The practicability of the adjustment for the firm.
- The financial and other costs of the adjustment.
- The firm's financial and other resources.
- The availability of external financial or other assistance.

**Practical Applications for Law Firms**

**For Clients**

**Communication**: Providing information in Braille, large print, or easy-read formats. Arranging for a qualified interpreter for meetings with a deaf client.

**Physical access**: Installing a ramp, widening doorways, or providing a ground-floor meeting room. Ensuring signage is clear and visible.

**Procedural adjustments**: Allowing a client with severe anxiety to provide instructions via email rather than face-to-face meetings. Allowing extra time for a client with a learning disability to process information and give instructions.

**Technology**: Ensuring the firm's website is compatible with screen-reading software.

**For Staff**

Providing specialised software (e.g., voice recognition software for a solicitor with a repetitive strain injury).

Modifying work patterns or allowing phased returns to work after sickness absence.

Reallocating minor or ancillary duties that an employee cannot perform because of their disability.

***Archibald v Fife Council*** [2004] IRLR 651 highlighted the potentially far-reaching nature of this duty. The House of Lords held that an employer was required to treat a disabled employee (a road sweeper who became unable to walk) more favourably by transferring her to a sedentary post without requiring her to compete for it. For law firms, this underscores that the duty can require positive discrimination in favour of a disabled person to alleviate a disadvantage.

### 3.3.4 Promoting Equality, Diversity and Inclusion: The Spirit of Principle 6

*Principle 6* of the SRA Code of Conduct requires solicitors to go beyond mere compliance with the law. It demands a conscious, active effort to "encourage" a fairer profession. This involves:

1. **In Recruitment and Career Progression**
    - **Blind recruitment**: Removing names, ages, and university names from CVs at the initial sifting stage to combat unconscious bias.
    - **Diverse panels**: Ensuring interview panels are themselves diverse to reduce individual bias and signal the firm's commitment to inclusion.
    - **Outreach**: Building relationships with schools and universities in diverse communities to widen the talent pool.
    - **Mentoring and sponsorship**: Implementing formal programmes to support the career progression of underrepresented groups within the firm.
2. **In the Workplace Culture**
    - **Clear policies**: Having robust, well-publicised policies on anti-bullying, harassment, and whistleblowing, with clear and trusted reporting channels.
    - **Training**: Providing mandatory, high-quality training on equality, diversity, and unconscious bias for all staff, including partners.
    - **Flexible working**: Normalising flexible working arrangements for all staff, which helps to prevent indirect discrimination against women and disabled people.
    - **Staff networks**: Supporting and funding networks for groups such as women, LGBTQ+ staff, or ethnic minority staff.
3. **In Service Delivery**
    - **Client diversity monitoring**: Anonymously monitoring the diversity of clients to identify any potential barriers certain groups may face in accessing services.

- **Community legal education**: Providing pro bono services and legal education tailored to the needs of underrepresented communities.
- **Inclusive marketing**: Ensuring the firm's marketing materials and imagery reflect the diversity of the society it serves.

**Consequences of Non-Compliance**

Failure to comply with the *Equality Act 2010* carries significant consequences, both legal and regulatory.

- **Legal liability**: A firm can face unlimited compensation awards in employment tribunals from staff, and claims for injury to feelings from clients in the county court. There is no cap on discrimination awards.
- **Regulatory sanction**: A breach of the Act is almost certainly a breach of SRA Principle 6 and potentially other principles (e.g., *Principle 2* on public trust, *Principle 5* on integrity). The SRA can investigate and impose sanctions ranging from a rebuke to an unlimited fine, and in the most serious cases, striking a solicitor off the roll.

## 3.4 Conclusion

The *Equality Act 2010*, when viewed through the lens of *SRA Principle 6*, requires a holistic and embedded approach. It is not a tick-box exercise but a continuous commitment to ensuring that the legal profession is, and is seen to be, a fair, accessible, and inclusive institution worthy of the public trust it holds. For the aspiring solicitor, this is not just a legal duty; it is a fundamental part of professional ethics and identity.

# 4

# ANTI-MONEY LAUNDERING REGIME; PURPOSE AND SCOPE

Imagine a criminal gang makes millions of pounds from dealing drugs, smuggling people, or corrupting public officials. They have vast amounts of cash, but they can't simply spend it. Buying a mansion or a fleet of supercars with suitcases of banknotes would quickly attract the attention of the police. So, they face a problem: how do they make their "dirty money" look "clean"? The process of disguising the criminal origin of money to make it appear legitimate is what we call money laundering.

For solicitors, this is not a distant issue from crime dramas; it is a daily professional risk. The legal system, with its ability to transfer property, manage complex finances, and create companies, can be misused by criminals to launder their money. Therefore, solicitors are on the front line of the fight against this crime.

This chapter introduces the severe social and economic harms caused by money laundering, the powerful UK laws designed to combat it, and the international cooperation that makes this fight possible. Understanding this regime is not optional; it is a critical part of your duty to uphold the rule of law and protect the public.

## 4.1 The Social and Economic Harm of Money Laundering

To truly understand the gravity of the anti-money laundering (AML) obligations placed upon solicitors, one must first move beyond a technical definition of the crime. Money laundering is not a victimless, paper-based offence that only concerns bankers and accountants. It is the essential lifeblood of serious criminality and a corrosive force that inflicts profound damage on society, the economy, and the very fabric of the rule of law that solicitors are sworn to uphold. Viewing it as merely a regulatory compliance issue is to miss the point entirely. The AML regime exists because the failure to combat money laundering enables and perpetuates a cycle of real-world harm.

### 4.1.1 The Vicious Cycle of Crime: From Dirty Money to Greater Harm

At its most fundamental level, money laundering is the process that makes crime pay—and pay handsomely. Without a mechanism to disguise the illicit origin of their profits and integrate them into the legitimate economy, large-scale criminal enterprises would be far less viable. The risks of holding vast amounts of unexplained cash would be immense, and the ability to enjoy or reinvest the profits would be severely limited.

**Fuelling organised crime**: The proceeds from one criminal venture are laundered to fund the next. The profits from a human trafficking ring are used to pay for a new shipment of drugs. The money from a series of armed robberies is invested in setting up a large-scale fraud operation. By successfully laundering money, criminals are able to expand their operations, diversify their illicit portfolios, and increase their power and influence. Every time a solicitor unknowingly facilitates the laundering of criminal proceeds, they are, in effect, providing the financial infrastructure that allows these destructive activities to continue and grow.

**Embedding corruption**: Money laundering and corruption are symbiotic evils. Corrupt public officials who accept bribes need to launder those bribes to enjoy their illicit wealth without detection. Conversely, criminal organisations use laundered funds to bribe officials in law enforcement, the judiciary, and government to avoid prosecution, secure lucrative contracts, or gain inside information. This undermines the integrity of public institutions and erodes the principle that everyone is subject to the law. A society where trust in public officials is compromised is one where the social contract begins to fray.

**Financing terrorism**: While the source of the funds may be different (often from legitimate-looking sources or small-scale fraud, rather than large-scale profit-driven crime), the methods used to obscure the movement of money for terrorist purposes are identical to those of money laundering. The legal and financial sectors are key battlegrounds in preventing funds from reaching terrorist organisations. A failure in AML controls can, therefore, have the most catastrophic of consequences.

#### 4.1.2 The Corrosive Economic Impact: Distorting Markets and Imposing Costs

The influx of laundered money into the legitimate economy acts like a poison, distorting market mechanisms and creating unfairness and instability.

**The distortion of asset prices**: Criminals with large amounts of cash to launder often invest in stable, high-value assets, with residential and commercial property being a prime target. They are frequently less concerned with achieving a market-rate return on investment and more focused on parking and legitimising their wealth. This artificial, criminally-funded demand can drive up property prices in certain areas, pushing home ownership out of reach for legitimate buyers and contributing to housing crises. The same effect can be seen in markets for luxury goods, art, and classic cars.

**Unfair competition for legitimate business**: Consider a criminal organisation that uses a chain of laundrettes or restaurants to launder cash. These businesses can operate indefinitely at a loss, underpricing their honest competitors because their real profit comes from the criminal funds they are washing, not from selling laundry services or meals. This "subsidised" competition can force legitimate, well-run businesses into bankruptcy, leading to job losses and hollowing out town centres. This is not free-market competition; it is economic sabotage.

**The erosion of financial and commercial integrity**: The integrity of the UK's financial system is one of its greatest assets. If international investors, businesses, and the public begin to perceive the UK as a place where "dirty money" can easily be moved and hidden, that reputation is tarnished. This can lead to a loss of confidence, reduced foreign investment, and higher costs of doing business as institutions are forced to implement even more stringent checks. The *Global Anti-Money Laundering Watchdog*, the Financial Action Task Force (FATF), can "grey-list" countries with weak AML controls, leading to significant economic disadvantages.

**The imposition of societal costs**: The crimes that generate the profits being laundered impose enormous costs on society. These include the direct costs of policing, the criminal justice system, and healthcare for victims, as well as the indirect costs of lost productivity and the human suffering caused by drug addiction, violence, and fraud. When money is successfully laundered, it reduces the funds available for asset recovery and increases the tax burden on law-abiding citizens and businesses to cover the costs of dealing with the consequences of crime.

### 4.1.3 The Undermining of Public Trust and the Rule of Law

Perhaps the most insidious harm caused by money laundering is its effect on the foundational principles of a just society.

**Erosion of trust in institutions**: The discovery that a respected bank, law firm, or accounting firm has been used to launder money on a massive scale shatters public confidence. It creates a perception that the system is rigged in favour of the wealthy and powerful, including powerful criminals. When people believe that institutions are corrupt or complicit, they lose faith in the fairness of society, which can lead to social unrest and political instability.

**The compromise of the legal profession**: For solicitors, this is a direct professional and ethical issue. The SRA Principles are clear: you must uphold the rule of law (*Principle 1*) and the public trust (*Principle 2*). A law firm that is used as a vehicle for money laundering betrays these core duties. It transforms a profession dedicated to justice into an unwitting accomplice of crime. The resulting reputational damage is not just to the individual firm but to the entire profession, undermining the trust that is essential for the solicitor-client relationship to function.

***Bowman v Fels*** [2005] EWCA Civ 226, while primarily about legal professional privilege, implicitly recognises the vital role solicitors play in the administration of justice and the tension that can arise when their work touches upon criminal conduct. The case underscores that a solicitor's duty to the court and the wider public interest can, in certain circumstances, override other duties.

The social and economic harms of money laundering are not abstract concepts. They are tangible, destructive forces that fuel the drug trade in local communities, push up the cost of housing, destroy honest businesses, and erode the trust that binds society together. For the aspiring solicitor, this understanding is the "why" behind the complex rules of *POCA* and the *MLR 2017*. It is the moral imperative that transforms AML compliance from a burdensome technical exercise into a fundamental professional duty. By being a vigilant and ethical gatekeeper, you are not just ticking a box; you are actively protecting society from grave harm and upholding the very principles that define your profession.

## 4.2 The UK AML Legislative Framework

The UK's defence against money laundering is a sophisticated, two-layered fortress. The first layer, the *Proceeds of Crime Act 2002* (POCA), is the criminal law backbone. It defines the money laundering offences themselves and arms the state with the power to confiscate criminal wealth. The second layer, the *Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017* (the *MLR 2017*), is the preventative and procedural rulebook. It imposes a set of mandatory, day-to-day duties on firms like yours to stop money laundering before it can even begin. For a solicitor, understanding the interaction between these two pillars is not merely academic; it is the key to navigating professional practice without committing a serious criminal offence or facing severe regulatory sanction.

### 4.2.1 Pillar 1: The *Proceeds of Crime Act 2002* (POCA); The Sword of the Law

POCA is a formidable piece of legislation that creates a wide-ranging and strict liability regime for dealing with the proceeds of crime. For solicitors, its most critical aspects are the principal money laundering offences and the failure to disclose offences, which apply to those in the "regulated sector."

**The Principal Money Laundering Offences (*Sections 327-329*)**

These sections target the core acts of handling criminal property. It is crucial to understand that "criminal property" is defined broadly as any property that constitutes a benefit from any criminal conduct, whether it occurred in the UK or abroad. The prosecution does not need to prove the specific underlying crime, only that the property represents a benefit from some kind of criminality.

1. ***Section 327*: Concealing, Disguising, Converting, Transferring or Removing Criminal Property from the UK.**

This offence covers the classic "laundering" acts, the physical or paper-based steps taken to hide the origin or ownership of dirty money.

**Example**: A client gives you £75,000 in cash, the proceeds of their illegal gambling operation, and asks you to use it as a deposit for a buy-to-let property purchase. By accepting the cash and placing it into your firm's client account with the intention of using it for the purchase, you are "converting" it (from cash to a bank balance) and potentially "disguising" its origin. This would constitute a *s.327* offence.

**The Mental element**: The offence is committed if you know or suspect that the property is criminal property. "Suspicion" is a low threshold. It is a state of mind that falls short of proof or knowledge but is more than mere speculation. It is that "vague feeling of unease" that something is not right.

2. ***Section 328*: Arrangements**

This is often described as the most dangerous offence for professionals. It criminalises becoming involved in an arrangement which you know or suspect facilitates (by any means) the acquisition, retention, use or control of criminal property by another person.

**Example**: You are acting for a client selling a high-value London property. The buyer's funds are coming from an opaque offshore trust, and the buyer is evasive about the source of wealth. You have a suspicion that the funds may be the proceeds of corruption from the buyer's home country. If you proceed to complete the conveyance, you are entering into an "arrangement" (the property transfer) that facilitates the acquisition of a clean, UK property (the criminal property) by the buyer. This is a S328 offence.

***P v P (Ancillary Relief: Proceeds of Crime)*** [2003] EWHC 2260 (Fam) is a landmark case that brought this risk into sharp focus for the legal profession. During divorce proceedings, it became apparent that the husband's assets were likely derived from serious criminal activity. The court held that it could not make a financial order that would involve the division or transfer of those criminal assets, as that would constitute a *s.328* "arrangement." The solicitors and the court itself were at risk of committing a money laundering offence by processing the transaction.

3. ***Section 329*: Acquisition, Use and Possession**

This is a simpler, but equally serious, offence. It involves merely acquiring, using, or possessing criminal property.

**Example**: A client pays your legal fees with a cheque that you later discover came from a known fraudster. By accepting and paying that cheque into your account, you have "acquired" criminal property.

### The Failure to Disclose Offences (*Sections 330-332*)

For those in the regulated sector, *POCA* imposes a positive duty to report. This creates a statutory "whistleblowing" obligation that overrides the common law duty of confidentiality to a client.

0. ***Section 330*: Failure to Disclose by a Person in the Regulated Sector**

This is a critical offence for any solicitor. It is committed if three conditions are met:

- You know or suspect, or have reasonable grounds for knowing or suspecting, that another person is engaged in money laundering.
- The information that gives rise to that knowledge or suspicion comes to you in the course of your work in the regulated sector.
- You fail to make a disclosure to your firm's Money Laundering Reporting Officer (MLRO) and then to the National Crime Agency (NCA) as soon as is practicable.

1. The most powerful element here is the "reasonable grounds" test. This is an objective standard. It does not matter if you are genuinely naïve, inexperienced, or have deliberately closed your mind to the obvious. If a reasonable, competent solicitor in

your position would have suspected money laundering, then you are deemed to have had those grounds. Turning a blind eye is not a defence.

**The Lifeline: The Authorised Disclosure and "Appropriate Consent"**

*Sections 327-329* create a terrifying dilemma: if you suspect a transaction involves criminal property, proceeding with it is a crime, but tipping off the client is also a crime (under *s.333A*). POCA provides a safe harbour through the mechanism of the Authorised Disclosure.

The process is as follows:

1. **Internal report**: You form a suspicion. You must immediately make a disclosure to your firm's MLRO in a timely manner.
2. **MLRO report**: The MLRO must then consider the report and, if they agree a suspicion exists, submit a Suspicious Activity Report (SAR) to the NCA.
3. **Seeking consent**: In the SAR, the MLRO can request "appropriate consent" from the NCA to proceed with the specific transaction(s) in question.
4. **The moratorium period**: The NCA then has 7 working days from the date of the SAR to respond. If they do not respond within that time, "deemed consent" is given and you may proceed with the transaction, protected by a statutory defence.
5. **The decision**: The NCA can either:
    - **Give consent**: You may proceed with the transaction.
    - **Refuse consent and issue a "Moratorium Notice"**: This prevents you from proceeding for a further 31 calendar days (which can be extended) while law enforcement investigates. Proceeding during this period is a criminal offence.

This process allows a solicitor to navigate the ethical and legal minefield, ensuring they do not become an accessory to money laundering while also avoiding the offence of "tipping off" the client.

### 4.2.2 Pillar 2: The Money Laundering Regulations 2017 (MLR 2017) - The Shield of Prevention

If the *Proceeds of Crime Act 2002* (*POCA*) is the sword that punishes money laundering after it has occurred, the *Money Laundering Regulations 2017* (*MLR 2017*) are the shield designed to stop it from happening in the first place. They represent a shift from a reactive to a proactive model of defence.

For a law firm, the *MLR 2017* are not merely a set of guidelines but a mandatory, risk-based framework of operational duties. A breach constitutes a criminal offence for the firm and its principals, and a clear breach of the SRA's Code of Conduct, potentially leading to fines, imprisonment, or being struck off the roll. This shield is constructed from several interlocking components, each vital to its overall strength.

**The Foundation: The *Firm-Wide Risk Assessment* (*Regulation 18*)**

You cannot protect against a risk you have not identified. The *Firm-Wide Risk Assessment* (FWRA) is the absolute cornerstone of the entire AML compliance structure. It is a mandatory, documented assessment in which the firm must proactively identify and evaluate its exposure to money laundering risks.

The assessment must be based on a comprehensive analysis of:

1. **Client risk**: Who are your clients? A firm acting for large, publicly listed companies has a different risk profile from one specialising in private clients with complex offshore structures or cash-intensive businesses.

2. **Geographic risk**: Where are your clients based or operating? Dealing with clients from or through jurisdictions identified by the FATF as high-risk (e.g., those on the "grey list") or known for high levels of corruption automatically increases the risk level.

3. **Product/service risk**: What services are you providing? Certain legal activities are inherently higher risk. Reserved activities like conveyancing (handling large sums of money) and the creation/administration of trusts (which can obscure ownership) are particularly vulnerable. Even non-reserved services like company formation can be high-risk if not managed properly.

4. **Delivery channel risk**: How is the service delivered? A client you never meet in person, who makes contact only online and uses complex corporate vehicles, presents a higher risk than a long-standing, locally-based client you meet face-to-face.

The FWRA is not a static document to be filed away. It is a living document that must be reviewed and updated regularly, and certainly when there are significant changes in the firm's business, the types of clients it acts for, or the emergence of new money laundering threats. It is the diagnostic report that informs every other AML action the firm takes.

**The Blueprint: Policies, Controls and Procedures (*Regulation 19*)**

Once the *FWRA* has diagnosed the risks, the firm must build its defences. *Regulation 19* requires the firm to establish written Policies, Controls and Procedures (PCPs) to mitigate and manage the risks identified in the FWRA. This is the firm's AML blueprint.

These PCPs must be proportionate to the size and nature of the firm's business but will typically include:

1. **CDD procedures**: Detailed, step-by-step guides on how to identify and verify clients and beneficial owners.

2. **Reporting procedures**: A clear internal pathway for employees to report suspicions to the Money Laundering Reporting Officer (MLRO), and for the MLRO to report to the NCA.

3. **Record-keeping procedures**: Mandating how and for how long (at least five years after the end of the business relationship) CDD records and transaction records are kept.

4. **Internal control procedures**: This includes the appointment of a dedicated MLRO and a Compliance Officer for Legal Practice (COLP), and systems for internal monitoring and audit to ensure compliance with the PCPs.

5. **Risk management procedures**: How the firm will apply a risk-based approach, including when to apply Simplified or Enhanced Due Diligence.

6. **Tipping-off procedures**: Guidance for staff on how to handle situations where they have made a disclosure, to avoid committing the separate offence of "tipping off" the client.

**The Daily Drill: Customer Due Diligence (CDD) & Enhanced Due Diligence (EDD)**

This is where the abstract concepts of the FWRA and PCPs are put into daily practice. CDD is the ongoing process of knowing your client.

Standard CDD (*Regulation 28*) involves three key actions:

1. **Identifying the client and verifying their identity**: This means obtaining a passport or driving licence and verifying it is genuine. For a corporate client, this means obtaining the certificate of incorporation and verifying its existence on Companies House.
2. **Identifying the beneficial owner and verifying their identity**: This is a critical step. The "beneficial owner" is the real, live individual who ultimately owns or controls the legal entity. For a company, this is any individual who owns more than 25% of the shares or voting rights, or who otherwise exercises control. You must pierce the corporate veil to find the human being at the end of the chain and verify their identity.
3. **Obtaining information on the purpose and intended nature of the business relationship**: Why has the client come to you? What is the specific transaction? You must understand the rationale behind the instruction.

Enhanced Due Diligence (EDD) (*Regulation 33*) is required when a situation is deemed higher risk based on your FWRA. EDD is not a different process; it is CDD done more thoroughly. Key triggers include:

1. **Politically Exposed Persons (PEPs)**: Individuals entrusted with prominent public functions (e.g., foreign heads of state, senior politicians, senior judges, military officers) and their family members and close associates. Their position makes them at higher risk for potential bribery and corruption.

2. **Clients from high-risk third countries**: Jurisdictions identified by the FATF or the UK government as having strategic AML deficiencies.

3. **Unusual or complex transactions**: Transactions that have no apparent economic or legal purpose, or that are unnecessarily complex for the stated goal.

EDD measures require you to:

- Obtain additional information on the client, the beneficial owner, and the intended nature of the relationship.
- Obtain information on the source of funds and source of wealth. This is crucial. Source of Funds (SoF) refers to *where the money for this specific transaction came from* (e.g., the sale of a property, a bank loan, a dividend). Source of Wealth (SoW) refers to *how the client accrued their overall net worth* (e.g., inheritance, business sale, lifetime of savings). Understanding this is key to assessing whether the funds are legitimate.
- Obtain senior management approval to establish or continue the business relationship.
- Conduct enhanced ongoing monitoring of the relationship.

**The Constant Vigil: Ongoing Monitoring (*Regulation 28(11)*)**

The duty of due diligence does not end when the client is onboarded. *Regulation 28(11)* imposes a duty of ongoing monitoring. This means you must continuously scrutinise the transactions and activities of the client throughout the relationship to ensure they are consistent with the firm's knowledge of the client, their business, and their risk profile, and must update the CDD information as necessary.

**Example**: A client for whom you drafted a will ten years ago suddenly instructs you to handle the sale of a £3 million commercial property. Their risk profile has changed dramatically. You must re-apply CDD, understand the source of the funds for this new transaction, and re-assess their risk level. Ongoing monitoring ensures that your knowledge of the client evolves with their circumstances.

**The Trained Guard: Training (*Regulation 24*)**

The most sophisticated FWRA and PCPs are useless if the staff do not understand them. *Regulation 24* mandates that firms provide regular AML training to all relevant employees. This includes not just fee-earners but also receptionists, secretaries, and cashiers, anyone who might be the first point of contact for a potential money launderer or who might spot a red flag.

Effective training must be:

- **Regular**: Provided upon induction and periodically thereafter.
- **Relevant**: Tailored to the firm's specific risk profile and the individual's role.
- **Up-to-date**: Reflecting changes in the law, the firm's PCPs, and emerging money laundering typologies.

*POCA* and the *MLR 2017* work in tandem. The *MLR 2017* require you to conduct CDD and be vigilant. This vigilance will, in turn, generate the "suspicions" or "reasonable grounds for suspicion" that trigger the reporting obligations under *POCA*. For the solicitor, this framework creates a continuous cycle of risk assessment, due diligence, and, where necessary, disclosure. It makes you a gatekeeper of the financial system, and the responsibilities that come with that role are among the most serious you will bear in your professional career.

## 4.3 The International Context: The Financial Action Task Force (FATF)

To view the UK's Anti-Money Laundering (AML) regime in isolation is to misunderstand its fundamental nature. Money laundering is a global enterprise; criminals exploit borders, seeking out jurisdictions with weak defences to legitimise their funds before reintegrating them into the mainstream global economy. A robust AML system in the UK would be rendered ineffective if illicit capital could simply be funneled through a jurisdiction with lax rules and then re-enter the UK as seemingly "clean" foreign investment. Therefore, the fight against money laundering is inherently an international one, reliant on cooperation and common standards. At the very heart of this global effort is the Financial Action Task Force (FATF), the international standard-setter whose work directly shapes the UK's *POCA* and *Money Laundering Regulations*.

### 4.3.1 The Financial Action Task Force (FATF): The Global Policymaker

Established in 1989 by the G7 group of industrialised nations, the FATF is an inter-governmental body whose mission is to set standards and promote effective implementation of legal, regulatory, and operational measures for combating money laundering, terrorist financing, and other related threats to the integrity of the international financial system. It is not a supranational legislator with direct law-making power, but its influence is profound. It operates as a global policy-making and monitoring body, creating a framework of peer pressure and mutual accountability.

The FATF's work is built upon three core pillars:

1. **The 40 Recommendations: The International Gold Standard**

   The FATF's 40 Recommendations provide a comprehensive and consistent framework of measures which countries should implement in order to combat money laundering and terrorist financing. They are universally recognised as the global AML/CFT (Combating the Financing of Terrorism) standard. The Recommendations are not static; they have been revised and strengthened over time to respond to evolving threats, such as the proliferation of weapons of mass destruction and the risks posed by new technologies.

   The Recommendations are logically structured to cover the entire AML/CFT ecosystem:

- Legal systems (Recommendations 1-3): Requiring countries to criminalise money laundering and terrorist financing, and to adopt laws for the confiscation of criminal assets.
- Measures to be Taken by Financial Institutions and Designated Non-Financial Businesses and Professions (DNFBPs) (Recommendations 4-23): This is the core of the preventative framework that directly impacts solicitors. It mandates:
    - Customer Due Diligence (CDD) and Record-Keeping (*Recommendations 10, 11 & 17*): The international origin of the UK's requirement to identify

clients, verify their identity, and understand the nature of the business relationship.

- Reporting of Suspicious Transactions (*Recommendation 20*): The basis for the obligation under POCA to submit Suspicious Activity Reports (SARs) to a Financial Intelligence Unit (FIU), which in the UK is the National Crime Agency (NCA).
- Other Measures for DNFBPs (*Recommendation 22*): This explicitly brings "legal professionals... when they prepare for or carry out transactions for their client" into the regulated sector, mandating CDD, reporting, and training. This is the direct international driver for the application of the MLR 2017 to law firms.

- Institutional and Operational Frameworks (*Recommendations 24-35*): Covering the establishment of competent authorities (like the SRA and NCA), their powers, and the importance of transparency regarding the beneficial ownership of legal persons and arrangements.

- International Cooperation (*Recommendations 36-40*): Emphasising mutual legal assistance, extradition, and the sharing of financial intelligence between countries.

For a solicitor, understanding that the detailed requirements of the *MLR 2017* are not arbitrary UK rules, but the implementation of a global standard, underscores their importance and universal applicability.

**2. Mutual Evaluations: Enforcing Compliance through Peer Review**

A standard is only effective if it is properly implemented. The FATF's mutual evaluation process is its primary tool for ensuring that member countries are not just adopting the Recommendations on paper, but are effectively enforcing them in practice.

This process involves a rigorous, on-site assessment by a team of experts from other FATF member countries. The assessment is incredibly detailed, examining both:

- **Technical compliance**: Whether the necessary laws, regulations, and institutional frameworks are in place.

- **Effectiveness**: Whether these measures are producing the desired results, that is, are they actually disrupting money laundering and terrorist financing?

The result is a public report that provides ratings on both technical compliance and effectiveness. These reports are highly influential. A poor rating is a significant mark of shame for a country, damaging its international financial reputation. For solicitors, these reports are also practical tools. The UK's own mutual evaluation report helps the SRA and the government identify weaknesses in the domestic system. Conversely, the reports on other countries are used by UK firms to identify high-risk jurisdictions, triggering the requirement for Enhanced Due Diligence under the *MLR 2017*.

### 4. Identifying High-Risk Jurisdictions: The "Grey List" and "Black List"

Perhaps the FATF's most publicly visible tool is its process of identifying jurisdictions with strategic deficiencies in their AML/CFT regimes.

- **The "Black List" (Call for Counter-Measures)**: This is the FATF's list of "High-Risk Jurisdictions subject to a Call for Action." These are countries the FATF deems to have such serious and persistent deficiencies that it calls on all members to apply enhanced due diligence and, in the most serious cases, apply counter-measures to protect the international financial system from the risks emanating from them. This is a severe step, effectively warning that a jurisdiction is non-cooperative.
- **The "Grey List" (Increased Monitoring)**: This is the list of "Jurisdictions under Increased Monitoring." These countries have committed to resolving strategic deficiencies within agreed timeframes and are subject to active monitoring. While not subject to a call for counter-measures, their presence on this list is a public flag that they pose a higher risk.

For a solicitor conducting due diligence, a client or a transaction connected to a country on the FATF grey or black list is an immediate red flag. It would be a clear trigger for Enhanced Due Diligence (EDD) under *Regulation 33* of the *MLR 2017*. This would require you to:

- Obtain additional information on the client and the source of wealth/funds.
- Obtain senior management approval to commence or continue the business relationship.
- Conduct enhanced ongoing monitoring of the relationship.

Failure to do so would be a breach of the *MLR 2017* and could leave you and your firm exposed to being used to launder the proceeds of crime.

**From International Standard to UK Law: The Implementation Chain**

The FATF's influence on the UK solicitor's daily practice is direct. The process works as follows:

1. The FATF sets or updates its International Standards (the 40 Recommendations).
2. The European Union (during the UK's membership) adopted these standards through its Anti-Money Laundering Directives (AMLDs). The UK's *MLR 2017* were the domestic implementation of the EU's 4th AMLD.
3. Post-Brexit, the UK remains a committed and founding member of the FATF. It now transposes FATF standards directly into UK law, as seen with the *Economic Crime (Transparency and Enforcement) Act 2022*, which created the Register of Overseas Entities in direct response to FATF recommendations on beneficial ownership transparency.

## 4.4 Conclusion

In conclusion, the FATF provides the essential international architecture that gives the UK's domestic AML regime its power and purpose. It ensures that the UK's efforts are aligned with a global strategy, preventing criminals from simply shifting their activities to the weakest link in the chain. For the solicitor, this international context transforms AML compliance from a parochial concern into a professional duty with global significance. By diligently applying the UK's rules, you are acting as a frontline defender not just of the UK's financial system, but of the integrity of the international financial system as a whole.

# 5

# AML IN PRACTICE: SUSPICIOUS ACTIVITY REPORTS

Knowing the law against money laundering is one thing; knowing what to do when you encounter it in your daily work is another. This chapter moves from the theoretical framework of the *Proceeds of Crime Act 2002* (POCA) and the *Money Laundering Regulations 2017* (MLR 2017) to the critical, practical actions you must take. The cornerstone of the UK's defensive system is the reporting of suspicions. When a solicitor suspects that they are being used to launder money, they face a legal and ethical crossroads. This chapter will guide you through that process.

We will first explore how to identify the vague but crucial concept of "suspicion" and the common 'red flags' that should trigger your alarm bells. We will then clarify the reporting chain, from your internal report to the external submission to the National Crime Agency (NCA). Finally, we will demystify the vital process of seeking consent to proceed with a transaction, a procedure that can serve as your legal defence. Understanding this process is not just about compliance; it is about fulfilling your duty as a gatekeeper of the legal system.

## 5.1 Identifying Suspicion: Circumstances and 'Red Flags' in Legal Practice

The entire edifice of the UK's Anti-Money Laundering (AML) reporting regime rests on a deceptively simple, yet profoundly important, legal and psychological concept: suspicion. For a solicitor, understanding the nature of suspicion is as crucial as knowing the procedural steps that follow it. Suspicion is the trigger, the catalyst that sets in motion a mandatory legal process. It is the line between passive observation and active duty. This section delves into the legal definition of suspicion, explores its subjective and objective facets, and provides a comprehensive catalogue of the practical 'red flags' that should alert a diligent solicitor to the possibility of money laundering.

### 5.1.1 The Nature of Suspicion: More Than a Hunch, Less Than Proof

Suspicion is not knowledge. You do not need proof, evidence, or certainty that a crime has been committed. Conversely, suspicion is not mere curiosity or a fleeting thought. The courts have struggled to define this state of mind with precision, but their guidance is clear.

- **A subjective state of mind**: Suspicion is, first and foremost, your own personal state of mind. It is a "feeling of unease," a "vague conjecture," or a "degree of satisfaction" that something is wrong. It is that nagging sense that a transaction or a client's instructions do not add up.
- **Based on objective grounds**: While the feeling is subjective, it cannot be baseless. The offence of "failure to disclose" under *s.330* of *POCA* applies if you know or suspect, or have reasonable grounds for knowing or suspecting. This "reasonable grounds" element creates an objective test. This is a critical safeguard. It means that even if you, personally, are naive, inexperienced, or deliberately turn a blind eye, you can still be convicted if a reasonable and competent solicitor in your position would have suspected money laundering. You cannot claim ignorance if the red flags were obvious to a prudent professional.

The case of ***K Ltd v National Westminster Bank Plc*** [2006] EWCA Civ 1039 is the leading authority. The court held that "suspicion is a word of everyday meaning, and it is not a term of art." It involves "a possibility, which is more than fanciful, that the relevant facts exist." This clarifies that while you don't need to believe it is probable, you must have a concrete reason for your unease that goes beyond pure fantasy. A gut feeling, if it is based on your professional experience and the observable facts before you, is a valid and legally significant suspicion.

### 5.1.2 A Catalogue of Red Flags in Legal Practice

Red flags are the observable symptoms that give rise to the internal feeling of suspicion. They are inconsistencies, unusual patterns, or behaviours that deviate from the norm for a legitimate transaction. A single red flag may only cause curiosity, but a combination of them should trigger a firm suspicion. The following are categorized red flags pertinent to a solicitor's practice.

1. **Client Identity and Behaviour Red Flags**
   - **Unusual secrecy**: A client is reluctant to provide personal details or becomes defensive when asked routine identification questions.
   - **Lack of knowledge**: The client demonstrates a surprising lack of knowledge about the transaction they are instructing you on, or their story seems rehearsed.
   - **Unnecessary intermediaries**: The client is represented by an intermediary who seems to be controlling the transaction, and the true beneficiary of the transaction is unclear or kept at a distance.
   - **Rushed or pressured instructions**: A client is in an unreasonable hurry to complete a complex transaction, displaying indifference to cost, risk, or the normal legal safeguards. They may pressure you to bypass standard procedures.
   - **Geographic disconnect**: There is no logical reason for the client to be using your firm (e.g., a client based abroad with no UK connections instructing a small local firm on a major London property deal).
2. **Source of Funds and Wealth Red Flags**
   - **Vague or inconsistent explanations**: The client cannot provide a clear, plausible, and verifiable account of where their money has come from. Their story may change when questioned.
   - **Mismatch with profile**: The source of funds is inconsistent with the client's known professional or financial profile (e.g., a student with no visible means of support instructing on a high-value purchase).
   - **Cash payments**: A request to pay large sums in cash, or the client arrives with large amounts of cash for a transaction that is normally conducted via bank transfer.

- **Complex funding routes**: Funds are routed through multiple jurisdictions or corporate entities in a way that seems designed to obscure their origin, with no clear business rationale.
- **Third-party payments**: Funds for a transaction are provided by an unrelated third party whose involvement is unexplained or seems illogical.

3. **Transaction-Based Red Flags**
    - **Unusual transaction structure**: The transaction is unnecessarily complex for its stated goal. For example, the use of multiple offshore companies in a simple property purchase.
    - **Lack of commercial sense**: The transaction makes no obvious economic sense. This includes a property being sold significantly above or below its market value, or a deal where one party seems to be acting against their own financial interest for no apparent reason.
    - **Last-minute changes**: Sudden and significant changes to the transaction instructions, particularly if they involve changing payment routes or beneficiaries, especially at the last minute.
    - **Overpayment**: A client unexpectedly overpays an invoice and urgently requests the surplus to be forwarded to a third party, often in a different jurisdiction.
4. **Red Flags Specific to Legal Practice Areas**
    - **Conveyancing**
        - A buyer purchasing a property with no intention of viewing it, living in it, or renting it out.
        - The use of corporate vehicles, especially offshore, to purchase residential property where the ultimate owner is concealed.
        - A seller requesting the proceeds of sale to be sent to a bank account in a high-risk jurisdiction unconnected to them.
    - **Trust and Company Formation**
        - A request to set up a complex structure of companies or trusts with no clear legitimate purpose, particularly if it involves nominee directors or shareholders.
        - Instructions where the true "beneficial owner" is hidden or the client is evasive about who will ultimately control the assets.

- **Litigation**
  - A case is settled unexpectedly quickly for an amount that does not reflect the legal merits, potentially as a way to legitimise a payment from one party to another.
  - ***Bhutta v Bhutta*** [2009] EWHC 2993 (Ch) is an illustrative case. While not a money laundering case itself, it involved a property transaction within litigation that displayed classic red flags: a sale at a significant undervalue to a relative, with a lack of independent advice and marketing. In an AML context, such a transaction would rightly trigger suspicion that it was designed to hide assets or move value clandestinely.

Identifying suspicion is an active and continuous professional duty. It requires a solicitor to be more than a legal technician; it requires them to be a critical thinker, professionally sceptical, and ethically alert. The "feeling of unease" is your professional instinct signalling that something is amiss. In the context of AML compliance, that instinct is a vital early warning system, and learning to recognise and act upon the red flags that trigger it is a fundamental skill for the modern solicitor.

## 5.2 The Appropriate Person/Body: Reporting to the National Crime Agency (NCA)

Understanding when to report a suspicion is the first critical step. Understanding to whom the report must be made is the second, and it involves a clearly defined chain of command. This pathway is not a matter of choice; it is a statutory requirement designed to ensure that intelligence is properly assessed, consolidated, and routed to the single national body with the authority and resources to act upon it. For a solicitor, navigating this pathway correctly is essential to fulfilling the legal duty to disclose and to accessing the vital defences provided by the Proceeds of Crime Act 2002 (POCA).

### 5.2.1 The Ultimate Destination: The National Crime Agency (NCA)

The ultimate external recipient for all Suspicious Activity Reports (SARs) in the United Kingdom is the National Crime Agency (NCA). Established in 2013, the NCA is the UK's lead agency for fighting organised crime; think of it as the British equivalent of the FBI. Its mandate includes tackling cybercrime, modern slavery, drug trafficking, and, crucially, the illicit finances that enable these crimes.

Within the NCA, the Financial Intelligence Unit (FIU) serves as the national central point for receiving, analysing, and disseminating SARs. The FIU does not investigate cases itself. Instead, it acts as a massive clearing house and intelligence hub:

- It receives all SARs from the entire regulated sector, including banks, accountants, estate agents, and solicitors.
- It analyses the data, looking for patterns, links, and trends that may not be visible to an individual firm reporting in isolation. A single SAR about a client might seem minor, but when combined with dozens of other SARs from different institutions about the same individual or network, it can reveal a large-scale money laundering operation.
- It disseminates this analysed intelligence to the most appropriate law enforcement body for investigation, which could be a local police force, a regional organised crime unit, or another specialist team within the NCA.

Submitting a SAR directly to the NCA is a legal requirement because it ensures that all intelligence is pooled in one place. This system prevents criminals from successfully laundering money simply by spreading their activities across multiple institutions, each of which only sees a small, seemingly innocuous part of the overall picture.

### 5.2.2 The Internal Choke Point: The Mandatory Internal Report

While the NCA is the final destination, a solicitor does not typically submit a report directly to the NCA in the first instance. *POCA* establishes a crucial internal step that must be followed.

The legal obligation, under *s.330* of *POCA*, is for the individual who first forms the suspicion to make a disclosure to their firm's Nominated Officer (Money Laundering Reporting Officer or MLRO) as soon as is practicable.

This internal reporting requirement serves several vital functions:

1. **Quality control**: The MLRO is (or should be) the firm's AML expert. They can assess the internal report, apply their experience and judgement, and determine whether the "suspicion" meets the threshold for an external SAR. This prevents the NCA from being flooded with low quality or frivolous reports from junior staff who may be overly cautious.

2. **Consolidation**: A single client or transaction might trigger suspicions in multiple fee-earners within the same firm. The MLRO can consolidate these separate internal reports into a single, more comprehensive and powerful SAR to the NCA, providing a fuller picture to the authorities.

3. **Insulation from tipping-off**: By channelling all reports through the MLRO, the firm minimises the risk of the suspect client being inadvertently alerted. The fee-earner can simply state that they need to seek advice from a senior colleague or the compliance department, which is a routine and non-alerting action.

4. **Creating a clear audit trail**: The internal report creates a documented record of the fee earner's vigilance and the MLRO's subsequent decision-making process. This is critical for demonstrating the firm's compliance to the SRA in the event of an audit or investigation.

### 5.2.3 The Consequences of Bypassing the Pathway

The reporting pathway is not a suggestion; it is a legal requirement with serious consequences for non-compliance.

1. **Failure to report internally**: An individual who forms a suspicion but fails to report it to the MLRO commits a criminal offence under *s.330* of *POCA*, regardless of whether they intended to commit a crime.

2. **Failure to report externally**: The MLRO, upon receiving an internal report that they themselves judge to be suspicious, commits a criminal offence if they then fail to report it to the NCA.

3. **Direct reporting to the NCA**: While an individual *can* make a direct "protected disclosure" to the NCA if they reasonably believe their internal report has not been acted upon, the standard and expected procedure is to report internally first. Bypassing the MLRO without good cause can create internal friction and may be viewed as a breach of internal policies.

The case of ***R v Anwoir and Others*** [2008] EWCA Crim 1354, while primarily about the definition of "criminal property," reinforces the centrality of the reporting obligation. The court outlined that the prosecution can prove property is criminal either by showing it stems from a specific kind of crime or by evidence of the circumstances, which are "such as to give rise to the irresistible inference that it can only be derived from crime." It is precisely this "irresistible inference" that the SARs regime is designed to capture and report. The failure to pass this inference up the chain to the NCA is what *POCA* criminalises.

In summary, the "appropriate person/body" is a two-stage concept. The first and immediate point of contact is your firm's MLRO. The ultimate and mandatory recipient is the NCA's Financial Intelligence Unit. This dual-path system ensures that the solicitor's initial "feeling of unease" is properly filtered, assessed, and fed into the national intelligence machinery, transforming a single subjective suspicion into a potentially valuable piece of the puzzle in the fight against organised and economic crime. For the solicitor, correctly following this pathway is the only way to discharge their legal duty and uphold their role as a gatekeeper of the legal system.

## 5.3 Procedure and Timing: The Defence Against Money Laundering (DAML) and Consent

Knowing you have a suspicion and knowing where to report it is only half the battle. The most complex and high-stakes part of the entire process is understanding how and when to report, and how to legally navigate the situation when the suspicious transaction you have identified is one you are expected to perform. This is where procedure is not just about compliance, but about accessing a vital statutory defence. The mechanism for this is the Defence Against Money Laundering (DAML), more formally known as seeking "appropriate consent."

Mastering this process is what separates a legally protected solicitor from one who is criminally liable.

### 5.3.1 The Step-by-Step Procedure: A Legal Lifeline

The procedure is a strict sequence designed to protect the solicitor, the firm, and the integrity of any subsequent criminal investigation.

**Step 1: The Immediate Internal Report**

- **Action**: The fee-earning solicitor who forms the suspicion must immediately complete an internal suspicious activity report and submit it to the firm's Nominated Officer (MLRO).
- **Timing**: This must be done "as soon as is practicable." This legal phrasing means without undue delay. You cannot wait until the end of the week or until after the transaction has completed. The moment your unease crystallises into a suspicion, the clock starts ticking.
- **Content**: The report must contain all relevant details: the client's information, the nature of the suspicious activity, the specific red flags observed, and the funds/transactions involved.

**Step 2: The MLRO's Assessment and the Decision to Report**

- **Action**: The MLRO must independently assess the internal report. They are not a mere post-box; they must apply their own professional judgement to decide if they, in their role, know or suspect that money laundering is occurring.
- **Outcome**: If the MLRO shares the suspicion, they are legally obligated to make an external disclosure to the NCA. If they do not believe the threshold is met, they must document their reasons for not proceeding. This decision carries significant risk, as an incorrect assessment could lead to their own prosecution for a failure to disclose.

**Step 3: The External DAML SAR to the NCA; The Crucial Step**

- **Action**: The MLRO submits the SAR to the NCA via its online portal. The critical element here is to indicate that this is a "Defence Against Money Laundering" (DAML) report. This is a specific tick-box or designation that signals to the NCA: "I am about to commit a principal money laundering offence by performing this transaction, and I am seeking your consent to proceed."

- **The "Appropriate Consent" request**: By filing a DAML SAR, the MLRO is formally requesting consent from the NCA under Sections 327-329 of POCA. This request is the solicitor's formal application for a legal defence.

### 5.3.2 The Moratorium Period: A Statutory Waiting Game

Once a DAML SAR is submitted, a legally defined "moratorium period" begins. This is a waiting period during which the solicitor is prohibited from proceeding with the suspicious transaction. The rules of this period are strict and non-negotiable.

1. **The initial period**: The NCA has 7 working days from the date of submission to respond.
2. **Deemed consent**: If the NCA does not respond within those 7 working days, the law states that "deemed consent" is given. At this point, the solicitor acquires a statutory defence and may proceed with the transaction without fear of prosecution for a principal money laundering offence.
3. **Refusal of consent & the Moratorium Notice**: If the NCA wishes to investigate, it will refuse consent and issue a "Moratorium Notice." This notice prohibits the solicitor from proceeding with the transaction for a further 31 calendar days (which can be extended by the NCA). If the solicitor proceeds during this moratorium period, they commit a principal money laundering offence, as the defence is no longer available.
4. **Express consent**: Alternatively, the NCA may give express consent to proceed before the 7-day period expires, also providing the solicitor with the defence.

This process can be visualised as a flowchart with critical decision points, where proceeding without the correct consent is a criminal act.

### 5.3.3 The Importance of Timing and the Peril of Getting it Wrong

The DAML process is the solicitor's only safe harbour. To proceed with a suspicious transaction without having gone through it, or by breaching its terms, is to sail directly into criminal liability.

The case of ***R v Duff*** [2019] 1 WLR 5408 is a canonical and sobering example. Here, a solicitor was instructed on a property transaction. He became suspicious that the purchase money was criminal property and submitted a SAR to the NCA. However, he then authorised the transaction to proceed before the 7-working-day moratorium period had expired and before the NCA had given consent. He was convicted for the principal money laundering offence of entering into an arrangement under *s.328* of *POCA*.

The Court of Appeal upheld his conviction, making several crucial points:

1. **The defence is conditional**: The statutory defence is only available if the solicitor waits for the moratorium period to expire or for consent to be given.
2. **Submission is not enough**: Merely submitting a SAR does not provide a defence. The defence is triggered by the consent (deemed or express), not by the report.
3. **Strict liability**: The court imposed a strict interpretation. The solicitor's belief that he was acting correctly was irrelevant. The law requires waiting for the specified period, and he did not.

This case is a permanent feature of AML training for a reason. It highlights that good intentions are not a defence. The procedure is mechanical and must be followed with precision.

#### Practical Implications for the Solicitor

In practice, this means:

- **Freezing the transaction**: Upon submitting a DAML SAR, you must effectively "freeze" the matter. You cannot take any further steps to advance the transaction.
- **Managing the client**: This creates a difficult client relations challenge. You cannot tell the client the real reason for the delay, as that would constitute the separate offence

of "tipping off." You must use neutral, non-alerting terms, such as "awaiting the outcome of internal compliance checks" or "completing standard administrative procedures."

- **Documenting everything**: The firm must keep meticulous records of the internal report, the DAML SAR submission, all correspondence with the NCA, and the timing of the consent (or refusal) received.

The procedure and timing surrounding DAML SARs represent the operational heart of a solicitor's AML duties. It is a legally mandated process that provides a clear, if sometimes challenging, path to avoid criminal liability. Understanding that the 7-working-day period is a protective shield, not a bureaucratic hurdle, is essential. The lesson from *R v Duff* is unequivocal: in the realm of money laundering, procedure is not just process, it is your defence.

## 5.4 Internal Reporting: The Role of the Nominated Officer (Money Laundering Reporting Officer)

While every solicitor has the duty to be vigilant, the effective functioning of a firm's anti-money laundering (AML) defences relies on a single, pivotal role: the Nominated Officer, more commonly known as the Money Laundering Reporting Officer (MLRO). This individual, appointed under *Regulation 21* of the *Money Laundering Regulations 2017*, is the central nervous system of the firm's AML compliance. They are the designated point to which all internal suspicions must flow and from which all critical decisions about external reporting emanate. The MLRO is not just an administrator; they are a decision-maker, a risk manager, and a gatekeeper, bearing significant personal and professional responsibility.

### 5.4.1 The MLRO as the Central Hub: More Than a Postbox

The MLRO's primary function is to receive and assess internal reports of suspicious activity. However, this role is far from passive. The MLRO acts as a crucial filter and analytical centre.

**Consolidation of intelligence**: Multiple fee-earners within a firm might have small, seemingly isolated concerns about the same client or transaction. The MLRO is in a unique position to piece these fragments together. What looks like a minor inconsistency to one solicitor might, when combined with another's observation, form a clear picture of suspicion that justifies a report to the National Crime Agency (NCA).

**Quality control and calibration**: Junior staff may be prone to over-reporting due to caution, while senior partners might be susceptible to under-reporting due to client relationship pressures. The MLRO applies consistent, objective judgement to assess whether the information in an internal report meets the legal threshold of "knowledge or suspicion" or provides "reasonable grounds for suspicion." This ensures that the firm submits high-quality, justified Suspicious Activity Reports (SARs) to the NCA, rather than flooding the system with unsubstantiated concerns.

**Maintaining the audit trail**: The MLRO is responsible for maintaining a confidential and detailed record of all internal reports, their assessment, and the subsequent action taken. This register is a vital piece of evidence for the SRA or a court, demonstrating the firm's proactive and compliant culture. It should document not only the reports that led to a SAR, but also those that were judged not to meet the threshold, along with the reasoning.

**The Decision-Making Burden: To Report or Not to Report?**

This is the MLRO's most significant and onerous responsibility. Upon receiving an internal report, the MLRO must make a binary, high-stakes decision: to submit a SAR to the NCA or not.

**The legal duty to report**: If the MLRO themselves knows or suspects that money laundering is occurring, based on the internal report, they commit a criminal offence under *s.331* of *POCA* if they fail to make an external disclosure to the NCA. This personal liability is a heavy weight.

**The risk of incorrect non-reporting**: The consequences of wrongly deciding *not* to report can be catastrophic. If money laundering subsequently comes to light, the MLRO and the firm face severe consequences, including:

- **Criminal prosecution**: For the MLRO personally, for a breach of Section 331 of POCA.

- **Regulatory action**: The SRA can take action against the MLRO (as a solicitor) and the firm for a breach of the *Principles*, particularly *Principle 1* (upholding the rule of law) and *Principle 2* (public trust).
- **Reputational damage**: The firm's reputation could be irreparably harmed.

**The "Reasonable Grounds" Test**: The MLRO must also consider the objective test. Even if they personally do not feel a suspicion, would a reasonable MLRO in their position have had "reasonable grounds to suspect"? This prevents an MLRO from avoiding liability by simply claiming they did not personally feel uneasy in the face of overwhelming objective evidence.

### 5.4.2 The Operational Commander: Beyond SARs

The MLRO's role extends far beyond just processing reports. They are the operational lead for the firm's entire AML framework.

1. **Liaison with law enforcement**: The MLRO is the single point of contact for the NCA and other law enforcement bodies. They manage all communication regarding SARs, including responding to requests for further information and handling any resulting Moratorium Notices.

2. Oversight of the consent regime: The MLRO is responsible for managing the Defence Against Money Laundering (DAML) process. This includes ensuring the firm does not proceed with a transaction while awaiting consent from the NCA, a point starkly illustrated in ***R v Duff***.

3. **Training and culture**: A key part of the MLRO's role is to foster a robust AML culture. They are responsible for ensuring that all staff receive regular, relevant training so they can recognise red flags and feel empowered and safe to make internal reports without fear of reprisal. They must create an environment where "a feeling of unease" is seen as a professional asset, not a nuisance.

4. **Internal policies and procedures**: The MLRO is typically instrumental in drafting, implementing, and updating the firm's AML policies, controls, and procedures, ensuring they are practical, effective, and aligned with the firm-wide risk assessment.

In essence, the MLRO is the guardian at the gate. They stand between the firm and the criminal justice system, interpreting intelligence, making judgement calls under pressure, and bearing ultimate responsibility for the firm's discharge of its AML obligations. For an aspiring solicitor, understanding this role is critical, not just for those who may one day become an MLRO, but for every solicitor who must interact with them. The effectiveness of the entire internal reporting system depends on the quality of the internal reports they receive, making every solicitor a sensor in the MLRO's early warning network. The MLRO's ability to protect the firm depends entirely on the vigilance and cooperation of their colleagues.

## 5.5 Conclusion

The SARs regime transforms the abstract duty to combat money laundering into a concrete, procedural obligation, where a solicitor's initial "feeling of unease," triggered by identifiable red flags, must be channeled through the critical internal filter of the Money Laundering Reporting Officer and, where justified, out to the National Crime Agency via a formal report, a process that is both a legal lifeline and a professional duty, with the strict Defence Against Money Laundering (DAML) consent procedure providing the essential statutory defence that allows a solicitor to navigate the perilous conflict between client instruction and criminal liability, thereby ensuring they act not only as a legal advisor but as a responsible gatekeeper upholding the integrity of the legal system.

# 6

# AML OFFENCES, DEFENCES AND DUE DILIGENCE

Understanding the framework for reporting suspicious activities is crucial, but it is equally vital to comprehend the specific offences that these reports are designed to prevent and the defences that protect those who act in good faith. This chapter delves into the core money laundering offences as defined by the *Proceeds of Crime Act 2002* (POCA), drawing a clear distinction between direct and non-direct involvement. We will explore the critical statutory defences available to solicitors, particularly the lifeline of "authorised disclosure."

Finally, we will move from the realm of criminal law to the practical, day-to-day preventative measures: the robust processes of Customer Due Diligence (CDD) and Enhanced Due Diligence (EDD). These are not mere administrative tasks; they are your primary shield against being implicated in a money laundering offence, ensuring you know your client and the origin of their funds before you ever act on their behalf.

## 6.1 Principal Money Laundering Offences under POCA 2002

The principal money laundering offences under the *Proceeds of Crime Act 2002* (POCA) form the criminal law bedrock of the UK's fight against illicit finance. For a solicitor, these are not abstract legal concepts; they are the specific, high-stakes pitfalls that must be navigated in daily practice. Understanding the nuances of *ss.327, 328, and 329* is essential because a breach can lead to a custodial sentence of up to 14 years, a fine, or both, not to mention the inevitable end of one's legal career.

These offences all revolve around the core concept of "criminal property," which is defined as a person's benefit from any criminal conduct, whether that conduct occurred in the UK or abroad. It is crucial to note that the prosecution does not need to prove the specific underlying crime; they only need to show that the property represents a benefit from *some* kind of criminality, and that the defendant knew or suspected this.

### 6.1.1 *Section 327*: Concealing, Disguising, Converting, Transferring or Removing Criminal Property

This offence covers the classic, foundational acts of money laundering; the physical and paper-based steps taken to hide the origin or ownership of illicit funds. The key verbs in this section are broad and capture a wide range of activity:

**Concealing or disguising**: This goes beyond simply hiding cash. It includes any act that obscures the true nature, source, location, disposition, movement, or ownership of the property. For a solicitor, this could involve:

- Placing criminal proceeds into a complex trust structure to make it difficult to identify the true owner.
- Creating legal documents, such as sham loan agreements, to give the appearance of legitimacy to a transfer of criminal funds.
- Using a client account to mix "dirty" money with clean funds, thereby "laundering" it through the legitimate financial system.

**Converting, transferring, or removing**: These verbs relate to the movement of criminal property. "Converting" means changing the form of the property (e.g., using cash to buy gold or property). "Transferring" means moving it from one person or place to another. "Removing" refers to taking it out of the UK jurisdiction.

**Example**

A new client instructs you to receive €200,000 in cash into your firm's client account. They explain the money is from the sale of a business abroad but provide no verifiable documentation. They then ask you to transfer the money to a corporate bank account in a different jurisdiction.

By receiving the cash (arguably "converting" it into a bank balance) and then transferring it on, you are performing acts that could constitute a *s.327* offence if you knew or suspected the cash was the proceeds of crime. The act of moving the money through your account, a seemingly legitimate channel, is the "disguising" element.

### 6.1.2 *Section 328*: Arrangements

This is often described as the most perilous offence for solicitors and other professionals. Its breadth is immense. It criminalises becoming involved in an arrangement which you know or suspect facilitates (by any means) the acquisition, retention, use, or control of criminal property by another person.

The term "arrangement" is interpreted very widely. It can encompass almost any professional service a solicitor provides; conveyancing a property, setting up a company, managing a trust, or even handling litigation.

What makes *s.328* so dangerous?

1. **The low threshold of involvement**: You do not need to handle the criminal property itself. Merely providing a service that assists your client in using or controlling their criminal property is sufficient.
2. **The "facilitation" element**: The offence is complete the moment you become involved in the arrangement with the requisite knowledge or suspicion. It is not necessary for money laundering to be successful.

**Example**

You are acting for a buyer in a residential property purchase. The funds are provided by a third party who is not a family member, and the client is evasive about why this person is providing the money. You conduct due diligence and discover the third party is under investigation for fraud. At this point, you suspect the funds are criminal property. If you proceed to complete the purchase, you are entering into an "arrangement" (the property conveyance) that facilitates the acquisition of a clean, UK asset (the property) by your client, using what you suspect is criminal property. This is a textbook *s.328* offence.

***P v P (Ancillary Relief: Proceeds of Crime)*** [2003] EWHC 2260 (Fam) is a landmark case that brought this risk into sharp focus. In divorce proceedings, it became apparent that the husband's assets were likely the proceeds of serious criminal activity. The court held that it could not make a financial order that would involve the division or transfer of those criminal assets. To do so would mean the solicitors and the court itself were entering into an "arrangement" to facilitate the control of criminal property, thereby committing a S328 offence. This case powerfully illustrates that no area of legal practice is immune from these obligations.

### 6.1.3 *Section 329*: Acquisition, Use and Possession

This is the most straightforward of the principal offences. It involves the simple acts of acquiring, using, or having control over criminal property. The distinction from S328 is that S329 typically applies to situations where the criminal property is for one's own benefit, rather than facilitating its use by another.

**Example**
A long-standing corporate client pays its substantial legal fees. Unbeknownst to you at the time, the payment was made from an account containing the proceeds of a large-scale VAT fraud carried out by the company's directors. When you later discover this information, you are technically in "possession" of criminal property (the funds paid to you). While a defence may be available if you had no prior suspicion and did not subsequently use the funds, the example shows how easily a firm can be exposed.

### 6.1.4 The Common Thread: The Mental Element

For all three principal offences, the prosecution must prove that the defendant knew or suspected that the property constituted or represented a benefit from criminal conduct. "Suspicion" is the low threshold; that "feeling of unease" or a "vague conjecture" that we explored in Chapter 5.

It is this mental element that links the solicitor's subjective state of mind to their objective actions, creating criminal liability for what might otherwise appear to be routine legal work.

For the aspiring solicitor, this makes constant vigilance and a professionally sceptical mindset your most important defence.

## 6.2 Direct Involvement and Non-Direct Involvement Offences

To fully grasp the scope of money laundering liability under *POCA*, it is essential to understand the crucial distinction between direct involvement and non-direct involvement offences. This distinction separates those who actively handle the "dirty money" itself from those who, through a failure to act, allow the laundering process to proceed unchecked. For a solicitor, this means you can be criminally liable not only for what you *do* with criminal property, but also for what you fail to do when you become aware of it.

### 6.2.1 Direct Involvement Offences: Handling the "Dirty Money"

The principal offences under *ss.327, 328, and 329* of *POCA* are classic examples of direct involvement offences. They involve a person taking a positive, active step in relation to criminal property.

**The common thread**: In each of these offences, the individual's actions are directly connected to the criminal property. They are "hands-on" with the illicit funds or assets.

***Section 327***: You are actively concealing, transferring, or converting the criminal property.

***Section 328***: You are actively entering into an arrangement that deals with the criminal property.

***Section 329***: You are actively acquiring, using, or possessing the criminal property.

**The solicitor's risk**: A solicitor commits a direct involvement offence when they perform legal work that involves dealing with the proceeds of crime. The legal service itself, whether it's completing a property purchase, setting up a trust, or managing a client account, is the positive act that constitutes the offence.

**Illustration (Direct Involvement - S328)**

A solicitor is instructed to incorporate a UK company and open a bank account for it. The client provides funds for this, but the solicitor suspects the money comes from embezzlement. The solicitor proceeds with the incorporation and facilitates the bank account opening. The company is then used to launder the embezzled funds.

**Analysis**: The solicitor has actively entered into an *arrangement* (incorporating the company and opening the account) which they suspected would facilitate the control of criminal property by the client. This is a direct involvement offence under S328.

### 6.2.2 Non-Direct Involvement Offences: The Failure to Act

In contrast, non-direct involvement offences criminalise a failure to perform a specific duty. The individual may not have touched the criminal property at all, but their inaction makes them complicit. The most critical non-direct involvement offence for solicitors is under *s.330* of *POCA*, which is failure to disclose.

This offence applies specifically to individuals working in the "regulated sector," which includes all solicitors in private practice.

The key elements of a *s.330* offence are:

1. The person knows or suspects, or has reasonable grounds for knowing or suspecting, that another person is engaged in money laundering.
2. The information on which this knowledge or suspicion is based came to them in the course of their work in the regulated sector.
3. They can identify the person involved in money laundering, the whereabouts of the laundered property, or the information on which their suspicion is based.
4. They fail to make the required disclosure to their firm's Nominated Officer (MLRO) and then to the National Crime Agency (NCA) as soon as is practicable.

### The "Reasonable Grounds" Test: The Objective Trap

The most powerful and far-reaching aspect of *s.330* is the "reasonable grounds" test. This creates an *objective* standard of liability. It is not solely about your personal, subjective state of mind.

This means:

- You can be convicted even if you are genuinely naive or inexperienced. If a "reasonable and competent solicitor" in your position would have seen the red flags and formed a suspicion, you are deemed to have had "reasonable grounds" for that suspicion. Your personal failure to recognise the obvious is not a defence.
- You cannot deliberately "turn a blind eye." Choosing to ignore obvious warning signs because you don't want to know the truth will not protect you. The law expects a proactive and vigilant approach.

### Illustrative Scenario (Non-Direct Involvement - S330)

A solicitor acts for a client buying a £2 million London property. The client has no visible source of wealth to support this purchase and the funds are routed through three different offshore companies in high-risk jurisdictions. The solicitor feels uneasy but decides not to investigate further, thinking, "I don't want to know, it's not my business," and completes the transaction without making a report.

Analysis: The solicitor may claim they did not personally "suspect" anything. However, a reasonable solicitor would have seen multiple glaring red flags, creating "reasonable grounds for suspicion." By failing to report this, the solicitor has committed a S330 offence, regardless of their subjective feelings. Their failure to act is itself a crime.

## 6.2.3 The Critical Relationship Between the Two

The two types of offences often operate in sequence, creating a double layer of risk.

1. A solicitor begins to perform a transaction (e.g., a property purchase).

2. During the process, they encounter red flags that give them a suspicion (or reasonable grounds for suspicion) that the client's funds are criminal property.

3. At this point, if they continue with the transaction, they risk committing a direct involvement offence (*s.328* - arrangements).

4. If they fail to report their suspicion to the MLRO and NCA, they simultaneously commit a non-direct involvement offence (*s.330* - failure to disclose).

This interplay was starkly demonstrated in ***R v Duff*** [2019] 1 WLR 5408. The solicitor, by proceeding with a transaction after submitting a SAR but before receiving consent, was convicted of the direct involvement offence (*s.328*). The case also implicitly highlights the non-direct failure; had he not reported his suspicion at all, he would have been liable under *s.330* as well.

## 6.3 Key Defences: Authorised Disclosure and the "Appropriate Consent"

The principal money laundering offences under *POCA 2002* are drafted so widely that they could potentially criminalise a solicitor for simply performing their job if they inadvertently handle criminal property. Recognising this, Parliament built in a vital safety mechanism: the defence of Authorised Disclosure and Appropriate Consent.

This is not merely a procedural formality; it is a statutory lifeline that allows a solicitor to navigate the ethical and legal minefield of acting for a client where suspicion has arisen. It provides a safe harbour, transforming a potentially criminal act into a protected one, provided the strict procedure is followed to the letter.

### 6.3.1 The Purpose of the Defence: A Path Through an Impossible Situation

Imagine a solicitor is instructed to complete a property purchase. The day before completion, they receive information that strongly suggests the client's deposit is the proceeds of fraud. The solicitor is now trapped in an impossible situation:

- If they proceed with the completion, they are entering into an arrangement to acquire criminal property, committing an offence under *s.328* of *POCA*.
- If they refuse to proceed and withdraw from acting, they risk "tipping off" the client that they are under suspicion, which is a separate offence under *s.333A*.
- Simply doing nothing and hoping the problem goes away constitutes a Section 330 offence (failure to disclose).

The Authorised Disclosure regime is the only legal way out of this trap. It allows the solicitor to freeze the transaction, report the suspicion to the state, and seek official permission to proceed, thereby avoiding criminal liability.

### 6.3.2 The Step-by-Step "Lifeline" Procedure

The defence is conditional upon following a strict, sequential process outlined in *ss. 337-339* of *POCA*.

#### Step 1: The Internal Disclosure

The fee-earner who forms the suspicion must first make a disclosure to the firm's Nominated Officer (Money Laundering Reporting Officer or MLRO). This must be done "as soon as is practicable" after the suspicion is formed.

#### Step 2: The Authorised Disclosure to the NCA

The MLRO, having independently assessed and shared the suspicion, must then make the formal "Authorised Disclosure" to the National Crime Agency (NCA). This is done by submitting a specific type of Suspicious Activity Report (SAR) known as a Defence Against Money Laundering (DAML) report.

The disclosure must be made before the prohibited act (e.g., completing the property purchase) takes place. A disclosure made after the event is not a defence. The disclosure must include:

- The identity of the person(s) involved.
- The whereabouts of the criminal property.
- The information that gave rise to the suspicion.

- A clear request for "appropriate consent" to perform a specified act.

### Step 3: The Moratorium Period and "Appropriate Consent"

Once the DAML SAR is submitted, a statutory "moratorium period" begins. This is a legally mandated waiting period. The NCA has 7 working days from the date of submission to respond. There are three possible outcomes:

1. **Deemed consent**: If the NCA does not respond within the 7 working days, the law states that "deemed consent" is automatically given. The solicitor then has a statutory defence and may proceed with the transaction.
2. **Express consent**: The NCA may give explicit, written consent to proceed within the 7-day period. This also provides the defence.
3. **Refusal of consent & moratorium notice**: The NCA can refuse consent and issue a "Moratorium Notice." This prohibits the solicitor from proceeding with the transaction for a further 31 calendar days (which can be extended) to allow law enforcement to investigate. Proceeding during this extended moratorium period is a criminal offence.

### 6.3.3 The Importance of Timing and Adherence to Procedure

The defence is exceptionally technical. It is not enough to simply have good intentions or to have reported the suspicion; the procedure must be followed with precision.

The case of ***R v Duff*** [2019] 1 WLR 5408 is the definitive and cautionary tale that every solicitor must know. In this case:

- A solicitor, Mr. Duff, was acting in a property transaction.
- He became suspicious that the purchase money was criminal property.
- He correctly submitted a DAML SAR to the NCA, seeking consent.
- However, he then authorised the transfer of funds and completed the transaction before the 7-working-day moratorium period had expired and before the NCA had given consent.

The Court of Appeal upheld his conviction for a *s.328* offence. The court made several critical rulings that underscore the absolute nature of the procedure:

- **The defence is conditional**: The defence is only available if the solicitor waits for the moratorium period to expire or for consent to be given. It is the *consent* that provides the defence, not the act of reporting.
- **Submission ≠ defence**: Merely submitting a SAR provides no protection whatsoever. Acting prematurely, even after a report has been made, is a criminal offence.
- **Strict liability**: The solicitor's belief that he was acting correctly was irrelevant. The law requires waiting for the specified period, and he did not.

This case makes it clear that the defence is a shield that is only activated upon the fulfilment of a strict condition. There is no room for approximation or assumption.

## 6.4 Customer Due Diligence (CDD) Requirements: Client Identity Verification

If the Authorised Disclosure regime is the emergency brake for when things go wrong, then Customer Due Diligence (CDD) is the continuous system of checks and balances designed to prevent problems from arising in the first place. CDD, as mandated by Regulation 28 of the Money Laundering Regulations 2017 (MLR 2017), is the foundational process of "knowing your client."

It is not a one-off administrative hurdle to be cleared at the start of a relationship; it is an ongoing, risk-based investigative process that forms the primary defensive barrier against a law firm being used to launder money. For a solicitor, robust CDD is the most practical and effective way to manage the risk of committing a principal money laundering offence, as it either prevents suspicion from arising or provides the documented evidence to justify a suspicion and make a report.

### 6.4.1 The Three Pillars of Standard CDD

The *MLR 2017* require firms to apply CDD measures when establishing a business relationship, carrying out an occasional transaction, or when a suspicion of money laundering arises. Standard CDD rests on three interconnected pillars:

1. **Identifying the client and verifying their identity**: This is the most familiar part of CDD. It involves obtaining information about the client and then confirming that information is genuine using reliable, independent sources.

    - **For an individual**: This means obtaining their full name, date of birth, and residential address. Verification typically involves seeing an original or certified copy of a government-issued photo ID (e.g., passport, driving licence) and a recent utility bill or bank statement for address confirmation.
    - **For a corporate entity**: This involves obtaining the company's registered name, trading name, company number, and registered office address. Verification requires checking the certificate of incorporation and conducting a search at Companies House to confirm the entity's legal existence and status.
    - **The "verification" principle**: It is not enough to simply collect documents. The firm must take reasonable steps to satisfy itself that the documents are authentic and that the client is who they claim to be. This is a proactive duty.

2. **Identifying the beneficial owner and verifying their identity**: This is the most critical and often the most challenging element of CDD. A solicitor must "look behind" the immediate client to identify the real, live individuals who ultimately own or control the client.

    - Who is a Beneficial Owner? For a company, a beneficial owner is any individual who ultimately owns or controls more than 25% of the shares or voting rights, or otherwise exercises control over the company's management (e.g., a shadow director).
    - For trusts and complex structures: The duty extends to identifying the settlor, trustees, beneficiaries, and any individual who has control over the trust. This requirement is designed to pierce the corporate veil that criminals often use to

hide their identity. A solicitor cannot accept instructions from "Company A Ltd" without knowing the human beings who ultimately stand to benefit from and direct those instructions.

For example, a client instructs you to set up a UK company, "ABC Holdings Ltd." The shareholder is another company, "XYZ Inc.", registered in an offshore secrecy jurisdiction. Standard CDD is not complete until you have identified the individuals who own and control XYZ Inc. Failing to do so would leave you open to the risk that you are setting up a corporate vehicle for a money launderer.

3. **Assessing and obtaining information on the purpose and intended nature of the business relationship**: This pillar requires the solicitor to understand the "why" behind the instruction. It moves beyond identity and into the substance of the matter.

    - What does this involve? You must understand the rationale and nature of the transaction. Why is the client buying this particular property? What is the commercial purpose of the company you are being asked to incorporate? What is the underlying reason for the litigation?
    - Why is it important? This understanding provides the essential context against which you can assess the client's future transactions and behaviour. If a client instructs you to set up a company for "general trading," but it suddenly starts receiving multi-million pound wire transfers, the stated "purpose" no longer matches the activity, which is a major red flag.

### 6.4.2 The Concept of Ongoing Monitoring

A common and dangerous misconception is that CDD is a task you complete at the start of a relationship and then file away. *Regulation 28(11)* of the *MLR 2017* imposes a clear duty of ongoing monitoring.

This means you must:

- Scrutinise transactions undertaken throughout the course of the relationship to ensure they are consistent with the firm's knowledge of the client, their business, and their risk profile.
- Keep CDD documents, data, and information up-to-date. Re-assess the client's risk if their circumstances or the nature of your instructions change significantly.

**Example of Ongoing Monitoring**

You act for a long-standing client for whom you have only ever drafted wills. Their risk profile is low. They then instruct you to handle the purchase of a £3 million commercial property. This is a fundamental change in the "intended nature" of your relationship. Your initial CDD, conducted years ago, is now insufficient. You must re-apply CDD, understand the source of the £3 million, and re-assess the client as a potentially higher risk. Failure to do so is a breach of the *MLR 2017*.

Effective CDD is a dynamic and interrogative process. It requires a solicitor to be professionally sceptical, to ask probing questions, and to refuse to accept vague or evasive answers. It is the process of building a comprehensive and verified profile of your client. This profile is your baseline; any deviation from it can trigger a suspicion, and the documented profile itself is your evidence of having taken the required preventative steps. In the fight against money laundering, CDD is not just paperwork, it is your first and most powerful line of defence.

## 6.5 Enhanced Due Diligence (EDD) and Ongoing Monitoring

For situations presenting a higher risk, standard CDD is insufficient. The MLR 2017 require Enhanced Due Diligence (EDD). This is not a different process; it is CDD done more thoroughly.

Key triggers for EDD include:

- **Politically Exposed Persons (PEPs)**: Individuals entrusted with prominent public functions and their family members/close associates.

- **Clients from high-risk third countries**: Jurisdictions identified by the FATF as having strategic AML deficiencies.
- **Unusual or complex transactions**: Transactions that have no apparent economic or legal purpose.

EDD measures require you to:

- Obtain additional information on the client and the beneficial owner.
- Obtain information on the source of funds and source of wealth. Source of Funds (SoF) refers to where the money for this specific transaction came from. Source of Wealth (SoW) refers to how the client accrued their overall net worth. This is crucial for assessing legitimacy.\Obtain senior management approval to establish or continue the relationship.

Furthermore, CDD is not a one-off event. Regulation 28(11) imposes a duty of ongoing monitoring. This means you must continuously scrutinise the transactions and activities of the client throughout the relationship to ensure they are consistent with your knowledge of the client, their business, and their risk profile.

***Abbey Life Assurance Co v Tattersall*** [2018] 9 WLUK 287, an employment case, illustrates the proactive thinking required. The tribunal found an employer should have considered transferring a disabled employee as a reasonable adjustment. For a law firm, this reinforces the duty to think creatively about removing disadvantages, whether for disabled employees or in identifying risks during EDD and ongoing monitoring. You must actively look for inconsistencies and be prepared to ask difficult questions.

## 6.6 Conclusion

This chapter has illuminated the intricate legal framework that governs a solicitor's conduct in relation to money laundering, establishing that liability arises not only from direct involvement with criminal property through the principal offences under Sections 327-329 of POCA 2002 but also from the critical failure to report suspicions as mandated by Section 330.

The vital statutory defence of Authorised Disclosure and Appropriate Consent serves as a necessary safeguard, providing a lawful pathway to navigate suspicious transactions, though its protection is conditional upon strict adherence to the prescribed procedure and moratorium periods, as starkly demonstrated in *R v Duff*. Ultimately, the proactive and continuous processes of Customer Due Diligence and Enhanced Due Diligence, mandated by the *MLR 2017*, constitute the foundational shield for solicitors, enabling them to verify client identities, understand the purpose of transactions, and monitor ongoing relationships, thereby fulfilling their essential role as gatekeepers of the legal system's integrity while managing their own criminal and regulatory risk.

# 7

# FINANCIAL SERVICES REGULATION

Imagine you are building a house, and you need to follow not just the building safety rules, but also the plumbing regulations, the electrical codes, and the planning permissions. The world of financial services is similar. While solicitors are experts in the law, their work often touches upon areas that are also heavily regulated by a separate, specialised system designed to protect consumers in the financial marketplace. This chapter explores the complex landscape of financial services regulation and how it intersects with legal practice.

We will introduce the key regulators and the overarching law, the *Financial Services and Markets Act 2000* (FSMA). We will then explore the crucial concept of the "Exempt Professional Firm," which provides a limited safe harbour for solicitors. You will learn to identify the triggers for regulation, "specified investments" and "regulated activities", and the important exemptions that allow you to advise on certain financial matters as part of your legal work. Finally, we will apply these rules to common scenarios involving insurance, mortgages, and investments, ensuring you can navigate this complex field with confidence and compliance.

## 7.1 The Financial Services Regulatory Framework

The UK's financial services industry is governed by a sophisticated regulatory structure established by the *Financial Services and Markets Act 2000* (FSMA 2000). This Act is the primary rulebook, setting out what activities are regulated and creating the framework for how they are supervised. FSMA 2000 operates on a fundamental principle: unless an activity is specifically exempt, a firm must be authorised by the regulator to carry on a regulated activity in the UK.

The regulators who enforce this rulebook are:

1. **The Financial Conduct Authority** (FCA): This is the conduct regulator for nearly all financial services firms in the UK. Its main focus is to protect consumers, ensure the integrity of the UK's financial markets, and promote competition. The FCA sets rules on how firms should behave, including how they communicate with clients, manage conflicts of interest, and ensure their products and services are fair. For most solicitors' firms, the FCA is the primary financial services regulator they will interact with.

2. **The Prudential Regulation Authority** (PRA): This is the prudential regulator, which is part of the Bank of England. The PRA's role is focused on the safety and soundness of the most systemically important financial institutions, such as banks, insurance companies, and major investment firms. Its job is to ensure these firms are well-run and have enough financial resources to withstand shocks, thereby reducing the risk of them failing. Most law firms will have little direct interaction with the PRA.

Think of it this way: if the financial system were a car, the PRA would be concerned with the engine's reliability and the strength of the brakes (the firm's financial health), while the FCA would be concerned with how the car is driven; the speed, the signalling, and the safety of the passengers (treating customers fairly).

## 7.2 How Financial Services Regulation Applies to Solicitors' Firms: The Exempt Professional Firm

The intersection of legal practice and financial services creates a potential regulatory minefield. If the act of advising on shares in a corporate transaction or arranging a mortgage in a conveyancing matter were to require full authorisation from the Financial Conduct Authority (FCA), the practice of law would become impossibly burdensome. To resolve this, the financial services regime, through the *Financial Services and Markets Act 2000* (*FSMA 2000*) and the Regulated Activities Order (RAO), provides a carefully defined safe harbour for solicitors: the status of an Exempt Professional Firm (EPF). This is not a blanket exemption from the rules, but a conditional permission that allows law firms to carry out certain regulated activities without direct FCA authorisation, provided they operate within strict boundaries designed to protect clients and prevent abuse.

### 7.2.1 The Nature of the Exemption: A Conditional Safe Harbour

The EPF status recognises that solicitors, in the normal course of providing legal advice, will inevitably touch upon financial matters. The exemption is built on the premise that the primary qualification, regulation, and ethical framework of the solicitor, overseen by the SRA, provides a sufficient level of consumer protection for these incidental financial activities. However, this privilege is contingent upon the firm adhering to several non-negotiable conditions. A breach of these conditions means the firm loses its exempt status and is immediately engaged in unauthorised regulated activities, a criminal offence under *FSMA 2000*.

### 7.2.2 The Core Conditions of Exemption

The conditions for operating as an EPF are designed to ensure that financial services activities remain subordinate and integral to the firm's legal practice.

1. **The Activity Must Be Incidental to the Provision of Legal Services**

   This is the most critical and often most nuanced condition. The regulated activity cannot be a standalone service; it must be ancillary, supplementary, and intrinsically linked to the core legal service being provided. The financial advice or arrangement must be a necessary step in achieving the client's legal objective.

   **Illustrative Examples**

   - A solicitor is handling the estate of a deceased client. The estate includes a portfolio of shares. The solicitor advises the executors to sell some of the shares to raise cash for the payment of inheritance tax and administrative expenses. Here, the act of advising on investments (the shares) is incidental to the legal service of estate administration. The primary purpose is to fulfil the legal and fiduciary duties of the executors, not to provide investment advice on the merits of the shares themselves.

- A client instructs a solicitor for the specific purpose of obtaining advice on how to invest a £100,000 inheritance they have received. The solicitor analyses different stocks, bonds, and funds and recommends a specific portfolio. This is not incidental to a legal service; it is the service. The solicitor is acting as a financial advisor and would require FCA authorisation.

The test is one of substance and purpose. Would the client have sought the financial advice independently of the legal matter? If the answer is yes, it is likely not incidental.

### 2. The Firm Must Not Receive Any Commission or Other Benefit from a Third Party

This condition is a cornerstone of preventing conflicts of interest and is perfectly aligned with the SRA's core principles, particularly *Principle 3* (independence) and *Principle 7* (acting in the best interests of the client).

**The rationale**: If a law firm could receive a commission from an insurance company for placing a client's policy, or from a fund manager for investing a client's money, its advice could be influenced by the size of the commission rather than the client's best interests. The solicitor might be tempted to recommend a product that pays a higher fee, even if a better or cheaper product is available for the client.

**The rule**: With very limited exceptions, an EPF must not receive any pecuniary reward or other material benefit from anyone other than the client. The firm's remuneration for the service must come solely from the client in the form of transparent legal fees.

**Consequence of breach**: Accepting a commission is a clear signal that the financial activity has crossed the line from being an incidental legal service to a standalone financial service, thereby invalidating the EPF status.

### 3. The Services Must Not Be Offered to the Public

This condition ensures that the exemption is used for the benefit of the firm's existing legal clients, not to run a parallel financial services business.

**What it means**: The firm cannot advertise, market, or hold itself out to the general public as a firm that carries on regulated activities. You cannot have a website that says, "We also provide independent financial advice."

**Permissible action**: The firm can inform its existing legal clients that, as part of its legal services, it can assist with related financial matters. For example, a conveyancer can tell a client they can help arrange the necessary buildings insurance for the new property.

The boundary: The moment a firm actively seeks out members of the public purely for its financial services, it ceases to be an EPF.

### 7.2.3 Ongoing Responsibilities: Exemption Does Not Mean Exclusion

It is a grave mistake to think that being an EPF means financial services rules do not apply. The firm remains subject to a dual regulatory burden.

**SRA Code of Conduct**: All the *SRA Principles* and Codes continue to apply in full. For instance, you must act with integrity (*Principle 5*), act in the best interests of the client (*Principle 7*), and manage your business effectively (*Principle 8*).

**FCA's High-Level Standards**: Even as an EPF, the firm is required to comply with the FCA's high-level standards for exempt professional firms. This includes the duty to act honestly, fairly, and professionally in accordance with the best interests of its clients (mirroring the SRA's principles) and to have adequate systems and controls in place to manage the regulated activities it undertakes.

In essence, the EPF status is a pragmatic regulatory solution that acknowledges the reality of integrated legal and financial advice. However, it is a privilege, not a right. It demands that solicitors exercise sharp professional judgement to ensure that their financial services activities remain a supporting act to their legal work, are free from compromising influences, and are offered only within the context of an existing solicitor-client relationship. For the aspiring solicitor, understanding and respecting the boundaries of the EPF status is essential to practising competently and ethically in a modern legal landscape.

## 7.3 Recognising Key Concepts: Specified Investments and Regulated Activities

Navigating financial services regulation is akin to navigating a complex legal code. Just as you must identify the relevant law and the specific action that breaches it, you must be able to identify two fundamental components to determine if a regulatory trigger has been pulled: the "Specified Investment" (the what) and the "Regulated Activity" (the how). The combination of these two elements is what creates the requirement for FCA authorisation. For a solicitor, developing an instinct for recognising these concepts in everyday practice is the first and most critical step in ensuring compliance and properly utilising the Exempt Professional Firm (EPF) status.

### Specified Investments: The "What"; The Regulated Financial Products

Specified Investments are the types of financial assets and instruments that fall within the regulatory perimeter. They are exhaustively listed in the *Financial Services and Markets Act 2000 (Regulated Activities) Order 2001* (the RAO). Think of this as the "regulated products" list. If the subject matter of your advice or action is not on this list, financial services regulation does not apply.

Key Specified investments relevant to legal practice include:

1. **Shares and debentures** (*Article 76*): This includes stocks and shares in companies, as well as debentures (a type of debt instrument). This is central to corporate law work. For example, advising on the transfer of shares in a private company as part of a shareholder agreement.
2. **Units in a collective investment scheme** (*Article 81*): These are essentially the shares or units that investors hold in a fund, such as an Open-Ended Investment Company (OEIC) or a Unit Trust. For example, an executor invests estate funds into a unit trust to provide for a minor beneficiary.
3. **Contracts of Insurance** (*Article 75*): This covers virtually all types of insurance, from life assurance and critical illness cover to professional indemnity insurance and buildings insurance. For example, arranging a life insurance policy to secure a mortgage or as part of estate planning.

4. **Rights under a Lender's Mortgage Contract** (*Article 61*): This is the borrower's right under a mortgage loan, typically used to purchase land. It is important to note that this is the *borrower's* interest, not the lender's. For example, advising a client on the terms of a mortgage offer from a bank.
5. **Deposits** (*Article 74*): This refers to money placed in a savings or current account with a bank or building society. The simple act of accepting client money into a client account is *not* taking a deposit, as it is not done in the course of deposit-taking business. However, advising on where to place large sums of money could be.

**Regulated Activities: The "How"; The Prohibited Actions**

Regulated Activities are the specific actions you perform in relation to a Specified Investment. The RAO defines these activities. Carrying on a regulated activity by way of business in the UK requires authorisation, unless an exemption applies.

Key Regulated Activities for solicitors include:

- **Dealing in investments as principal or agent** (*Article 14*): This means buying, selling, subscribing for, or underwriting investments on your own behalf (principal) or on behalf of someone else (agent). The example of an agent is a solicitor acting for a seller of a company, executing the transfer of the company's shares to the buyer.
- **Arranging (bringing about) deals in investments** (*Article 25*): This is a very broad activity. It involves making arrangements with a view to another person buying or selling a specified investment. You do not need to execute the transaction yourself; merely facilitating it can be enough. For example, introducing a client to a stockbroker or a mortgage broker with the intention that they enter into a transaction. Simply providing a name from a list may not be arranging, but actively facilitating the introduction with the clear purpose of a deal being made likely is.
- **Managing investments** (*Article 37*): This involves managing assets belonging to another person if those assets include specified investments, and the manager has discretion over how those assets are managed. For example, A solicitor-trustee of a will trust has discretion over whether to sell or retain the shares held within the trust portfolio.

- **Advising on investments** (*Article 53*): This means giving a person advice on the merits of buying, selling, subscribing for, or underwriting a specified investment, or exercising any right to do so. A crucial distinction is that giving generic information (e.g., "There are two types of shares: ordinary and preference") is not advising. Giving a recommendation (e.g., "You should sell your ordinary shares in X plc and use the proceeds to buy units in Y fund") is advising on investments.
- **Arranging or advising on regulated mortgage contracts** (*Articles 25A & 53A*): These are specific activities related to mortgages, covering the facilitation of, or advice on, a borrower entering into a regulated mortgage contract.
- **Insurance distribution activities** (*Articles 21A & 56A*): This includes advising on a contract of insurance and arranging a contract of insurance.

**The Combination is Key**

Financial services regulation only applies when two specific things happen at the same time. You must be dealing with a certain type of product and you must be doing a certain type of activity with it.

Think of it like driving a car. There are specific rules for driving a "car" (the type of product) on a "public road" (the type of activity). The rules don't apply if you're only sitting in a car on your own driveway, or if you're riding a bicycle on a public road. You need both parts for the full set of driving rules to apply.

Here's how it works for solicitors:

**Part 1: The "What"; Is it a Regulated Financial Product?**

This is the list of financial products that the FCA cares about. They are called "Specified Investments." Examples include shares in a company, insurance policies, mortgages, units in investment funds.

**Part 2: The "How"; Is it a Regulated Financial Activity?**

This is the list of actions you do with those products that the FCA regulates. Examples include arranging a deal to buy them, advising someone on whether to buy or sell them, managing them for someone else.

The Rule is that you need FCA authorisation if you are doing a Regulated Activity with a Specified Investment. Now, let's apply this simple two-question test to the scenarios.

**Scenario 1: The Commercial Lease**

Client asks: "Should I sign this commercial lease for my new shop?"

Question 1: Is it a Specified Investment?

A commercial lease is a property contract. It is not a share, an insurance policy, or a mortgage. Therefore, the answer is NO.

Question 2: Is it a Regulated Activity?

It doesn't matter, because we already failed Question 1.

The final result is that it is not regulated by the FCA. It is just legal advice, which is what solicitors do. The SRA oversees this, not the FCA.

**Scenario 2: General Company Law Advice on Shares**

Client asks: "As a shareholder, what are my legal rights to see the company's accounts?"

Question 1: Is it a Specified Investment?

The subject is shares in a company. Shares are definitely on the list. Therefore, the answer is YES.

Question 2: Is it a Regulated Activity?

You are explaining their legal rights as a shareholder. You are not telling them to buy or sell. This is legal advice, not financial advice on the merits of the investment. Thus, the answer: NO.

This is not regulated by the FCA. You are acting as a solicitor giving general legal advice about a financial product, which is fine.

**Scenario 3: "Should I Sell My Shares?"**

Client asks: "Given the current market, should I sell my ABC Ltd shares now or wait?"

Question 1: Is it a Specified Investment?

The subject is *shares*. The answer is YES.

Question 2: Is it a Regulated Activity?

The client is asking for your opinion on the financial merits of selling an investment. This is the exact definition of "Advising on Investments." Thus, the answer is YES.

In conclusion, this IS a regulated activity. The full force of financial services regulation now applies.

**What To Do When It's Regulated**

When you get a "YES" to both questions, you have entered FCA territory. But as a solicitor, you have a special permission slip called Exempt Professional Firm (EPF) status.

This permission slip has one main condition: the financial activity must be "incidental" to your legal work. This means it must be a necessary part of solving a legal problem, not the main service itself.

- **This is INCIDENTAL (You can do it)**

  As a result, you can advise an executor to sell shares in an estate to pay inheritance tax bills. You can also recommend a client get buildings insurance because it's a requirement for their mortgage and you are handling their house purchase.

- **This is NOT INCIDENTAL (You CANNOT do it)**

A client calls you up and says, "I have £50,000 to invest, what stocks should I buy?" This is standalone financial advice with no legal matter attached. To do this, you would need full FCA authorisation.

In simple terms:

1. First, use the two questions to check if you're in FCA land.
2. If you are, then check if your reason for being there is to help with a legal case (incidental).
3. If it is, your EPF status lets you proceed. If it isn't, you must stop and refer the client to a regulated financial advisor.

## 7.4 Relevant Exemptions for Legal Practice (e.g., the 'Professionals Exemption')

Alongside the EPF status, there are specific exemptions in the RAO that are vital for legal practice. The most important is the "Professionals Exemption" (*Article 67* of the RAO).

This exemption allows a firm that is regulated by the SRA (or another professional body) to carry on the regulated activity of "arranging deals in investments" or "advising on investments" without needing FCA authorisation, provided:

1. The activity is incidental to the provision of professional services (the same test as for the EPF status).
2. The firm does not hold itself out as carrying on a regulated activity (again, reinforcing the EPF condition).
3. The firm's remuneration is not separate from its professional fees.

This exemption is a crucial tool. For example, when a solicitor in a corporate department arranges for the sale of a company's shares, they are "arranging deals in investments." The Professionals Exemption covers this activity because it is incidental to the legal service of handling the corporate transaction.

## 7.5 Application of *FSMA 2000* to Common Scenarios

The true test of understanding financial services regulation is applying it to the messy reality of legal practice. The theoretical concepts of "specified investments" and "regulated activities" only become meaningful when tested against real-world client instructions. For a solicitor, the danger lies not in the obviously financial transaction, but in the everyday legal task that has a financial component embedded within it. This section provides a deeper dive into three core practice areas, illustrating the regulatory triggers and the precise boundaries of the Exempt Professional Firm (EPF) status with extended examples and analysis.

### 7.5.1 Insurance Distribution: Beyond Simple Arranging

While arranging buildings insurance in a conveyancing matter is the classic example, insurance distribution can arise in numerous legal contexts. The key is the nature of the advice and the action taken.

**The Standard Conveyancing Matter**

You provide the client with a list of three insurance providers from a panel your firm has vetted. The client chooses one, and you forward their details to the provider to initiate the policy.

**Analysis**: This is clearly "arranging" a contract of insurance. It is incidental to the legal service of acquiring a property, as the client legally requires insurance to secure a mortgage and protect their asset.

**EPF Application**: Permissible. You must ensure you have conducted a fair analysis of the market to create your panel (or use a whole-of-market service) and provide the client with clear information about the insurance, in line with the Insurance Distribution Rules.

### The Contentious Probate Matter

You are acting for a beneficiary challenging a will. You advise the client that, due to the potential legal costs and duration of the case, they should consider taking out After-the-Event (ATE) insurance to cover the risk of having to pay the other side's costs if they lose.

**Analysis**: You are "advising on" and "arranging" a contract of insurance. The insurance is a litigation tool, not a personal financial product.

**EPF Application**: This is highly likely to be considered incidental to the provision of legal services (litigation). Your advice is driven by the needs of the case, not a detached analysis of the insurance market. Your firm must not receive a commission from the ATE provider.

### The Corporate Acquisition

As part of a company purchase, you identify that the target company has inadequate professional indemnity insurance. You advise the acquiring client that they should require the sellers to rectify this as a condition of the sale and recommend a suitable level of cover.

**Analysis**: This involves "advising on" a contract of insurance. The advice is given in the context of a commercial negotiation and risk assessment.

**EPF Application**: This is incidental to the corporate legal service. The advice is about mitigating a commercial legal risk identified during due diligence, not about selling an insurance product.

## 7.5.2 Mortgage Activities: The Line Between Facilitator and Adviser

Mortgage activities are a minefield because the client's primary need is financial, yet the solicitor's involvement is legally necessary. The distinction between permissible facilitation and regulated advice is critical.

### The Facilitator

A client has already secured a mortgage offer in principle from their bank. They send you the formal mortgage deed from the lender for you to explain and witness their signature as part of the property purchase.

**Analysis**: You are explaining a legal document. You are not "arranging" the mortgage, as the deal has already been brought about by the client and the bank. This is the provision of pure legal advice.

**EPF Application**: This is not a regulated activity. It is a core legal function.

**The Limited Adviser (The "Gatekeeper")**

A client needs a mortgage. Your firm has a panel of five lenders whose standard documentation you are familiar with. You provide the client with a list of these five and suggest they compare the rates. The client picks one, and you help them complete the application form.

**Analysis**: This is "arranging" a regulated mortgage contract. You have facilitated the deal by providing a curated list and assisting with the process.

**EPF Application**: This is permissible if incidental to the conveyancing. You must provide a clear disclosure to the client stating that you are not independent and are only recommending from a limited panel. You must not receive a commission.

**Crossing the Line into Regulated Advice**

The same client in the scenario above cannot decide between two lenders on your panel. They ask you, "Which one is better for me?" You analyse their personal finances, the loan-to-value ratios, and the long-term cost of the two products, and you recommend one over the other because it has a lower overall cost.

**Analysis**: You are now "advising on" a regulated mortgage contract. You have moved from facilitating a client's decision to making a recommendation based on the product's financial merits.

**EPF Application**: This is a high-risk area. While arguably still incidental to the conveyancing, this level of personalised financial advice pushes the boundaries of the exemption. A firm must be very cautious here and ensure it has the competence to give such advice without straying into acting as a regulated mortgage advisor.

### 7.5.3 Investment Activities: The Incidentality Test Under Pressure

This is where the "incidental" condition is most severely tested, as the value of investments can be the central subject of the legal matter.

**Trustee's Discretion (Permissible)**

As a solicitor-trustee, you decide to sell shares in a volatile technology company held by the trust and reinvest the capital into a mix of government bonds and blue-chip equity funds to provide a more stable and diversified income for the life tenant.

**Analysis**: This involves "managing investments" and "dealing as agent." The decisions are driven by your fiduciary duty to balance the interests of the life tenant and the remainderman.

**EPF Application**: This is the classic example of where the Professionals Exemption and EPF status apply. The regulated activities are incidental to the discharge of your fiduciary duties as a trustee.

**Matrimonial Finance (The Grey Zone)**

In a divorce, you advise your client that they should seek a larger share of the pension assets and a smaller share of the cash ISAs, because the pension has better long-term growth prospects and tax efficiency for their retirement needs.

**Analysis**: This is "advising on investments" (pensions and ISAs are specified investments). The advice is given to achieve a fair division of assets in the divorce.

**EPF Application**: This is a contentious area. The SRA's view has generally been that strategic advice on the legal and tax consequences of different assets in a settlement is legal advice. However, advice based purely on an assessment of the future financial performance of one investment over another likely crosses the line and may not be considered incidental. The safe approach is to recommend the client take specific financial advice on the investments themselves.

**Standalone Investment Advice (Not Permissible)**

A long-standing client for whom you have done wills and property work calls you and says, "I've just inherited £200,000. What should I invest in?" You research the market and recommend a portfolio of specific stocks and funds.

**Analysis**: This is pure "advising on investments." There is no underlying legal matter to which this advice is incidental.

**EPF Application**: This is not permitted under the EPF exemption. The solicitor would be acting as an unauthorised financial advisor, a criminal offence. The only compliant response is to decline to give the advice and refer the client to a regulated financial advisor.

In all these scenarios, the solicitor's overriding duty is to the *SRA Principles*, particularly *Principle 7* (acting in the client's best interests). The financial services rules provide the detailed framework for how to do this when dabbling in financial activities. The modern solicitor must constantly ask: "Am I doing this as a necessary part of solving my client's legal problem, or am I acting as their financial advisor?" The answer to that question determines which side of the regulatory line they stand on.

## 7.6 Conclusion

This chapter has demystified the complex intersection between legal practice and financial services regulation. We have established that the UK's regulatory framework, centred on the *Financial Services and Markets Act 2000* and enforced by the FCA and PRA, is not a separate world from legal practice but one that frequently overlaps with it. The crucial understanding for any solicitor is that liability is triggered only when a specific *regulated activity* is performed in relation to a *specified investment*, a two-step test that must be applied rigorously to daily client instructions.

The status of an Exempt Professional Firm provides a vital, conditional safe harbour, allowing solicitors to navigate this overlap when the financial activity is incidental to the provision of legal services, provided they do not receive third-party commissions or hold themselves out to the public as financial advisors.

Ultimately, navigating this landscape successfully requires a solicitor to consistently exercise professional judgement, discerning the critical line between providing integrated legal solutions that have a financial component and straying into the territory of standalone financial advice, thereby ensuring they remain on the right side of the law while fully serving their clients' needs.

# 8

# PRIVATE FUNDING AND ALTERNATIVE FEE STRUCTURES

If you hire a builder to fix your roof, you could pay them for every single hour they work, agree on one fixed price for the whole job, or even strike a deal where they only get paid if they successfully stop the leak. The world of legal fees operates on similar principles. How a solicitor charges for their services is a fundamental aspect of the solicitor-client relationship, impacting affordability, risk, and access to justice.

This chapter explores the various ways clients can fund legal services privately, moving beyond the traditional billable hour. We will examine the certainty of fixed fees, the risk-sharing model of Conditional Fee Agreements (CFAs), often called "no win, no fee," and the more recent Damages Based Agreements (DBAs), which are the UK's version of contingency fees.

Understanding these structures is not just about legal accounting; it is about fulfilling your duties to provide clear costs information, manage client expectations, and ensure your firm is financially sustainable, all while upholding the core SRA Principles.

## 8.1 Private Retainer: The Traditional Hourly Rate Model

The private retainer, often referred to simply as "paying by the hour," is the bedrock upon which the traditional business model of many law firms is built. It is a straightforward concept: the client purchases the solicitor's time, expertise, and effort. While it may seem simple, this model is governed by a complex web of professional obligations, practical challenges, and ethical considerations. For a solicitor, mastering the hourly rate model is not just about recording time; it is about managing client relationships, justifying value, and ensuring strict compliance with the SRA's stringent transparency rules.

**The Mechanics: Time Recording and Billing**

At its core, the model functions on a simple equation: Time Spent x Hourly Rate = Fee.

**Time recording**: Solicitors and fee-earners are required to record their time in units, typically six-minute increments (0.1 of an hour). Every activity related to a client's matter is recorded; phone calls, emails, drafting documents, research, and attendance at meetings or court.

**Hourly rates**: These are not arbitrary. A firm's hourly rates are set based on the experience, expertise, and seniority of the fee earner. A newly qualified solicitor will have a significantly lower rate than a partner with 30 years of specialist experience. Rates are also influenced by the firm's location, overheads, and the complexity of the work undertaken.

**Example of a Bill**

- Partner (2.5 hours @ £450 per hour) = £1,125
- Associate (5 hours @ £300 per hour) = £1,500
- Trainee Solicitor (3 hours @ £175 per hour) = £525
- Subtotal for Professional Fees: £3,150
- Plus Disbursements (e.g., court fees, expert reports) = £500
- Total Bill: £3,650

### 8.1.1 The Role of Payments on Account

A fundamental feature of the private retainer model is the payment on account. This is a request for the client to pay money upfront, which is held by the firm in its client account and used to pay future bills as they are raised.

**Purpose**: It is a key risk management tool for the firm. It ensures that the firm is not effectively lending money to the client to fund their case, protecting the firm's cash flow and preventing bad debt. It also provides the client with certainty that funds are available to progress their case without interruption.

**SRA Compliance**: The *SRA Accounts Rules 2019* strictly govern how these client funds must be handled. They must be kept in a designated client account, separate from the firm's own money, and can only be transferred to the office account (to pay fees) once a bill has been issued and falls due for payment.

### 8.1.2 SRA Transparency Rules: The Duty of Clear Communication

The SRA *Code of Conduct for Solicitors* imposes a clear duty regarding costs. *Principle 7* (acting in the client's best interests) and *Principle 8 (*running your business effectively) are directly engaged.

The specific obligations are set out in Chapter 8 of the Code. A solicitor must:

1. Give the client the best possible information about likely overall costs, both at the outset and as the matter progresses.
2. Explain the basis of the charges, including the hourly rates of the people who may carry out the work.
3. Explain the client's liability for any disbursements (third-party costs) and their responsibility to make payments on account.
4. Inform the client if the costs are likely to exceed an initial estimate and explain any changed circumstances.

Failure to provide clear costs information is one of the most common sources of client complaints to the Legal Ombudsman. A client who receives a large, unexpected bill can rightly claim they were not properly advised, which can lead to the firm being forced to reduce its fees.

While not a case about hourly rates *per se*, the principles in ***Minkin v Lesley Landsberg (Practising as Barnet Family Law)*** [2015] EWCA Civ 1152 are instructive. The court emphasised the scope of a solicitor's duty to advise, which is intrinsically linked to the costs of that advice. A solicitor must ensure the client understands the financial implications of the retainer they are entering into.

### Advantages and Disadvantages in Practice

#### Advantages for the Firm

1. **Fair compensation**: The firm is paid for all work done, reflecting the true effort and complexity of a case.
2. **Predictability**: It provides a steady and predictable revenue stream, which is essential for business planning and stability.
3. **Suitable for complex matters**: It is the most appropriate model for open-ended, complex, or unpredictable matters where the scope of work cannot be defined in advance, such as commercial litigation or merger and acquisition transactions.

#### Disadvantages for the Firm

1. **Administrative burden**: It requires rigorous and disciplined time recording from all staff.
2. **Client relations**: It can lead to difficult conversations and disputes if clients feel the time recorded is excessive or does not represent good value for money. This is known as the "value question."
3. **Perceived misalignment of interest**: Clients may sometimes suspect that the firm has an incentive to be inefficient or to prolong a matter to run up more hours, a perception the solicitor must actively manage through clear communication.

#### Advantages for the Client

1. **Pay for effort**: The client pays only for the actual work done on their case.
2. **Transparency**: A detailed, itemised bill provides a clear breakdown of exactly what work was done and by whom.

### Disadvantages for the Client

1. **Cost uncertainty**: The total cost is unknown at the outset, which can cause significant anxiety and make budgeting difficult.
2. "**Bill shock**": The final bill can be much higher than the client anticipated, especially if the case becomes more contentious or complicated than first thought.

In essence, the private retainer model demands a relationship of trust. The solicitor must be transparent, efficient, and communicative to justify the costs being incurred. The client must have confidence that the time being recorded is necessary and proportionate. For the aspiring solicitor, this means understanding that time is not just a metric for billing, but a resource you are managing on behalf of your client, with a corresponding duty to use it wisely and account for it meticulously

## 8.2 Fixed Fees: Certainty for Client and Firm

A fixed fee is an agreed, single price for a defined piece of legal work. This model shifts the risk of cost overruns from the client to the law firm. The solicitor assesses the work required for a specific service (e.g., drafting a will, handling an uncontested divorce, incorporating a company) and quotes a single, all-inclusive price.

### Key Features

1. **The scope is crucial**: The fixed fee must be tied to a very clear scope of work. The client care letter must specify what is included and, just as importantly, what would be considered "out of scope" and lead to additional charges.
2. **SRA compliance**: Providing a fixed fee is an excellent way to comply with the SRA's transparency requirements, as it gives the client absolute certainty from the outset.

### Advantages

**For the client**: There is complete cost certainty and no surprises. This is highly attractive for individuals and small businesses budgeting for legal costs.

**For the firm**: It can be a powerful marketing tool to win clients who are wary of open-ended hourly rates. It also incentivizes efficiency within the firm.

**Disadvantages**

**For the firm**: If the firm underestimates the complexity or time required, it may end up working at a loss. It requires accurate scoping and project management skills.

**For the client**: If the matter is simpler than expected, the client may end up paying more than they would have under an hourly rate.

## 8.3 Conditional Fee Agreements (CFAs): The 'No Win, No Fee' Model

A Conditional Fee Agreement (CFA) is a funding arrangement where the client only pays their own solicitor's fees if the case is successful. This is commonly used in litigation, such as personal injury, clinical negligence, and employment cases, to provide access to justice for clients who could not otherwise afford to bring a claim. The solicitor and client sign a CFA. If the client loses the case, the solicitor does not charge their fees. If the client wins, the solicitor charges their normal fees (usually calculated on an hourly rate basis).

**Key Features**

1. **Risk transfer**: The financial risk of losing the case is transferred from the client to the solicitor.
2. **After-the-event (ATE) insurance**: Because a losing client would still typically have to pay the opponent's legal costs, they will usually take out an ATE insurance policy to cover this risk. The premium for this policy can often be deferred and only paid if the case is won.
3. **SRA Principles**: CFAs must be entered into carefully. The solicitor must ensure the case has a good enough chance of success to justify the risk (upholding *Principle 1* - the administration of justice) and must explain the agreement in clear, understandable terms to the client (*Principle 7* - acting in the client's best interests).

## 8.4 Success Fees and Recoverability in Litigation

To make CFAs commercially viable for law firms, the system originally allowed for a "success fee." This was a percentage uplift on the solicitor's normal fees, intended to compensate the firm for the risk of taking on other cases that they might lose.

**The original regime**: Under the *Courts and Legal Services Act 1990*, a success fee of up to 100% of base costs could be charged. Crucially, this success fee was recoverable from the losing party.

**The Jackson Reforms and the change**: The recoverability of success fees was heavily criticised for distorting litigation costs. Following *Lord Justice Jackson's* review of civil litigation costs, the *Legal Aid, Sentencing and Punishment of Offenders Act 2012* (LASPO) came into force in April 2013.

**The current position**: For CFAs entered into after April 2013, the success fee is no longer recoverable from the losing party. Instead, any success fee must now be paid by the client, and it is capped in certain types of cases (e.g., at 25% of the damages for personal injury claims, excluding future care and loss). This fundamental shift means the cost of the success fee now comes out of the client's damages, making it a critical factor for the client to consider.

***Heron v TNT*** [2013] EWHC 3622 (QB) is a post-LASPO case that grappled with the new costs regime. It highlighted the complexities that arose during the transition and underscored the new reality that success fees are now a matter between solicitor and client, not a cost to be imposed on the other side.

## 8.5 Damages Based Agreements (DBAs): The UK's Version of Contingency Fees

A Damages Based Agreement (DBA) is a true contingency fee agreement. Unlike a CFA where the solicitor charges their hourly fees upon success, in a DBA the solicitor's reward is a percentage of the client's damages. The solicitor and client agree that if the case is lost, the solicitor gets nothing. If the case is won, the solicitor's fee is an agreed percentage of the compensation the client receives.

**Key Features**

1. **Percentage cap**: In employment tribunal cases, the cap is 35% of the client's compensation. In civil litigation, the cap is 50% of the damages, inclusive of VAT.
2. **No payment if you lose**: As with CFAs, the client pays nothing if they lose.
3. **Hybrid DBAs are prohibited**: A solicitor cannot charge under a DBA and also charge an hourly rate. The DBA percentage is the sole reward for the solicitor.

**Advantages**

**For the client**: It perfectly aligns the solicitor's interest with their own. The solicitor only wins if the client wins big. The client has no upfront costs.

**For the firm**: The potential reward can be much higher than under a CFA if the damages are substantial.

**Disadvantages**

**For the firm**: The risk is extremely high. A firm could invest thousands of hours in a complex case and receive nothing if it loses. The reward is also uncertain and depends on the final damages award.

**For the client**: They give up a significant portion of their compensation. A client awarded £100,000 under a 30% DBA would pay £30,000 to their solicitor.

The case of ***Lexlaw Ltd v Zuberi*** [2021] EWCA Civ 16 provided crucial clarity on DBAs. The Court of Appeal confirmed that a DBA could include a term requiring the client to pay the solicitor's disbursements (e.g., court fees, expert reports) if the client decided to terminate the agreement early. This decision provided more certainty for law firms entering into these high-risk agreements.

The choice of funding model is a strategic decision with profound implications for both the client and the firm. A solicitor must carefully advise on the options, explaining the risks, rewards, and financial implications of each with absolute clarity, thereby ensuring the client can make an informed choice and the solicitor manages their practice in a way that is both ethical and commercially sustainable.

## 8.6 Conclusion

In conclusion, this chapter has illuminated the critical landscape of private funding and alternative fee structures, demonstrating that the method of charging for legal services is far more than a mere administrative detail, it is a fundamental aspect of the solicitor-client relationship that directly impacts access to justice, risk allocation, and the commercial viability of legal practice.

We have seen that while the traditional hourly rate model provides a clear correlation between effort and cost, it places the financial risk and uncertainty squarely on the client. In contrast, alternative fee structures like fixed fees, Conditional Fee Agreements (CFAs), and Damages Based Agreements (DBAs) represent a significant shift towards risk-sharing and cost certainty.

These models, particularly the post-LASPO CFA and DBA regimes, require solicitors to carefully balance the duty to provide access to justice with the need to run a sustainable business, all while providing clients with the transparent advice required by the SRA Principles.

Ultimately, the choice of funding model is a strategic decision that demands careful consideration of the specific matter, the client's circumstances, and a clear-eyed assessment of risk, ensuring that the chosen structure aligns the interests of both solicitor and client in the pursuit of a just outcome.

# 9

# PUBLIC FUNDING; LEGAL AID

Imagine a society where your ability to get justice in court depends entirely on how much money you have. A person facing eviction, a victim of domestic abuse seeking protection, or someone wrongly accused of a crime might be unable to defend their rights or prove their innocence. The legal aid system exists to prevent this injustice. It is the government's provision of funding to pay for legal advice and representation for those who cannot afford it themselves.

This chapter explores the modern legal aid framework, which was dramatically reshaped by the *Legal Aid, Sentencing and Punishment of Offenders Act 2012* (LASPO). We will unravel the two key gates to accessing civil legal aid: the means test (how much money you have) and the merits test (how strong your case is). We will then examine the different gateway for criminal legal aid, known as the "Interests of Justice" test.

Finally, we will detail the specific types of cases that are still within the "scope" of legal aid today, a list that has become much narrower since the implementation of LASPO. Understanding this system is essential for any solicitor who wishes to help those most in need of access to justice.

## 9.1 The Modern Legal Aid Framework: LASPO Act 2012

Prior to 2012, legal aid was available for a wide range of civil legal problems. The *LASPO Act 2012*, which came into effect in April 2013, represented the most significant reform of the legal aid system in its history. Its primary purpose was to reduce the government's legal aid budget by millions of pounds per year.

The Act achieved this by making a fundamental change: instead of legal aid being available for most areas of law unless specifically excluded, LASPO flipped this principle on its head. Now, legal aid is only available for specific types of cases that are explicitly listed in the Act. If a case is not on this list, it is "out of scope," and legal aid cannot be granted, no matter how poor the client or how strong their case.

The main consequences of LASPO include:

1. **A drastically reduced scope**: Whole areas of law were removed from scope, including most private family law (e.g., divorce and child contact where there is no evidence of abuse), most housing law (except for serious disrepair or homelessness), and the vast majority of welfare benefits, employment, and clinical negligence cases.
2. **The creation of legal deserts**: In many parts of the country and for many areas of law, it is now very difficult to find a legal aid provider, as many law firms could no longer sustain this part of their practice financially.
3. **A rise in litigants in person** (LiPs): Courts have seen a significant increase in the number of people representing themselves because they cannot afford a lawyer and are ineligible for legal aid, which can slow down court proceedings and create challenges for the judiciary.

***R (on the application of UNISON) v Lord Chancellor*** [2017] UKSC 51, while primarily about employment tribunal fees, powerfully reaffirmed the constitutional right of access to justice. The Supreme Court stated that the value of access to the courts is not purely economic. This principle underpins all criticism and analysis of the LASPO reforms, highlighting that while saving money is a legitimate aim, it cannot be done in a way that effectively prevents people from enforcing their legal rights.

## 9.2 Eligibility for Civil Legal Aid

Gaining access to civil legal aid is like trying to get through a castle gate with two separate, heavily guarded doors. A person must successfully unlock both doors to enter. The first door is the Means Test, which asks, "Are you poor enough?" The second door is the Merits Test, which asks, "Is your case strong and important enough to be worth public money?"

A failure at either door means legal aid will be refused. For a solicitor, conducting a rigorous initial assessment of both tests is a crucial first step in any potential legal aid matter, ensuring that time is not wasted on applications that are doomed to fail and that public funds are applied for appropriately.

### 9.2.1 The Means Test: A Detailed Financial Investigation

The Means Test is a forensic examination of the client's financial situation. Its purpose is to ensure that legal aid is reserved for those who genuinely cannot afford to pay for legal representation themselves. The test is complex and involves several stages, looking at both income and capital.

The assessment is typically carried out by the Legal Aid Agency (LAA) based on information and evidence provided by the solicitor.

1. **Assessment of Disposable Income**

   This calculates how much money the client has left each month after accounting for essential living costs.

- **Gross income**: The client's total income from all sources is added up. This includes earnings from employment, benefits, pensions, and any other regular income.
- **Allowable deductions**: Certain deductions are then made from gross income to arrive at a "disposable income" figure. These include income tax and National Insurance contributions, council tax, rent or mortgage interest (but not capital repayments) and fixed allowances for dependants (e.g., children) and necessary living expenses.
- **The income thresholds**: If the client's disposable income is below a lower threshold, they pass the means test automatically and will not have to contribute. If their disposable income is above a lower threshold but below an upper threshold, they may still be eligible, but they will be required to pay a monthly contribution from their

income towards their legal costs. If their disposable income is above the upper threshold, they will be ineligible for legal aid.

2. **Assessment of Capital**

This looks at the client's savings and valuable assets.

- What is included? Savings in bank accounts, stocks, shares, investments, and property (other than the client's main home, which is usually disregarded).
- **The capital threshold**: If a client's disposable capital is above a set limit (currently £8,000 for most types of case), they will be ineligible for legal aid, regardless of their income. If their capital is below this limit but above a lower threshold, they may be required to pay a one-off contribution from their capital.

**Example of the Means Test**

Maria is a single parent with two children. She works part-time and receives state benefits. Her gross monthly income is £1,400. After deducting tax, national insurance, and her living allowances for herself and her children, her disposable income is calculated to be £150 per month. This is below the lower threshold. She has £500 in a savings account. Maria would pass the means test and be granted legal aid without any contributions.

### 9.2.2 The Merits Test: Is the Case a Good Bet for Public Funds?

The Merits Test exists to ensure that legal aid is only spent on cases that have a reasonable chance of success and where it is a sensible use of limited public resources. It is not enough to be poor; you must also have a worthy case. The specific test applied varies depending on the type of case.

1. **Prospects of Success**

This is a fundamental requirement. The solicitor must provide a detailed opinion on the likelihood of the client winning their case. The LAA uses a standard scale:

- "Poor" (less than 50%) - Funding will be refused.
- "Borderline" (about 50%) - Funding may be granted in certain circumstances.
- "Moderate" (50% or better) - This is the usual minimum threshold for funding.

- "Good" (60-80%) or "Very Good" (80%+) - Funding is likely to be granted.

2. **The Cost-Benefit Test (For cases with a financial value)**

Also known as the "cost-benefit" or "proportionality" test, this asks whether the likely legal costs are justified by the potential benefit to the client. The LAA will not fund a case where it would cost £10,000 in legal fees to recover a £2,000 debt. The solicitor must show that the likely damages or value to the client outweighs the estimated costs.

3. **The Public Interest Test**

In some cases, funding may be granted even if the personal benefit to the client is small, if the case has a wider public importance. For example, a case that could clarify an important point of law for thousands of people might satisfy this test.

4. **Reasonableness of Funding the Case**

The LAA will consider whether a reasonable private paying client, with the means to do so, would be willing to fund the case themselves. If the case is too risky or the potential reward too low, a private client would not proceed, and therefore legal aid should not be granted either.

**Example of the Merits Test**

John wants to challenge a local authority's decision that he is "intentionally homeless" and therefore not entitled to housing. He has evidence that contradicts the council's findings.

- **Prospects of success**: Based on the evidence, his solicitor assesses his chances as "moderate" to "good" (above 50%).
- **Cost-benefit**: The benefit to John is avoiding homelessness, which is a profound non-financial benefit. The costs are justified.
- **Public interest**: The case may also ensure the council correctly applies the law to others.

This case would have strong merits and likely qualify for funding.

***R (Gabaj) v Legal Aid Agency*** [2022] EWHC 579 (Admin) illustrates the rigorous application of the merits test. In this case, the claimant's application for legal aid for a judicial review was refused because the LAA concluded his case did not have a "moderate" prospect of success. The High Court upheld the LAA's decision, demonstrating that the assessment of merits is a substantive one, and the courts will be slow to interfere with the LAA's judgment if it has been properly conducted.

The Means and Merits tests are the twin pillars of the legal aid system. For a solicitor, advising on eligibility is a critical first step. It requires a careful analysis of the client's financial paperwork and a clear-headed, objective evaluation of the strengths and weaknesses of their legal case. This process ensures that the vital safety net of legal aid is preserved for those who are both financially eligible and whose cases truly warrant the investment of public money.

## 9.3 Eligibility for Criminal Legal Aid

In the criminal justice system, the stakes are the highest an individual can face: the loss of their liberty, the imposition of a life-changing criminal record, and the resulting damage to their reputation, employment, and family life. The principle that a person is innocent until proven guilty is a cornerstone of our law, but this principle is meaningless if an individual cannot effectively defend themselves. Criminal legal aid exists to ensure that the power of the state, with its vast resources and professional prosecutors, is not brought to bear against an unrepresented and vulnerable individual. While a financial means test is still a key part of eligibility, the primary and most important gateway for criminal legal aid is the "Interests of Justice" test.

### The Foundation: Why a Different Test is Needed

The "Interests of Justice" test, often referred to as the "Widgery Criteria" after the judge who first set them out, recognises that criminal cases are fundamentally different from civil disputes. It is not merely a question of means and merits. The test is based on the understanding that a fair trial, a right protected by Article 6 of the European Convention on Human Rights, often requires professional legal representation to be effective. The state has a duty to ensure that the trial process is fair, and providing a lawyer is a key part of fulfilling that duty.

### 9.3.1 The "Interests of Justice" Criteria: A Closer Look

The test is set out in statute and requires the decision-maker (usually the Legal Aid Agency or the court) to consider a list of factors. It is not necessary to satisfy all of them; satisfying just one can be enough to pass the test.

The key criteria are:

1. The individual is at real risk of losing their liberty or livelihood. This is often the most powerful factor. If the offence with which the person is charged is punishable by imprisonment, it is almost always in the interests of justice for them to be represented. The prospect of going to prison is so serious that the accused must have a skilled advocate to challenge the case against them.
   **Example**: David is charged with common assault, a summary-only offence with a maximum penalty of six months in prison. Even if the case seems straightforward, the mere fact that he could be sentenced to custody means it is almost certain he will pass the Interests of Justice test.

2. The case involves a substantial question of law. If the case is not just about the facts but turns on a complex or novel point of law, a layperson cannot be expected to argue it effectively.

   **Example**: Sarah is charged with a public order offence. Her defence hinges on the precise legal meaning of "threatening, abusive or insulting" behaviour and whether her actions were a legitimate protest protected by the Human Rights Act. This requires legal expertise to argue.

3. The individual needs to trace and interview witnesses or cross-examine them effectively. Many cases turn on the evidence of witnesses. A defendant cannot be expected to professionally interview potential witnesses to build their defence, nor can they effectively cross-examine a witness in court to challenge their credibility or evidence. This is a skilled task.

**Example**: Mark is accused of theft. His defence is that he was elsewhere at the time (an alibi). He needs his solicitor to track down and take statements from people who were with him to prove this. He also needs his barrister to cross-examine the prosecution witness who claims to have seen him at the scene.

4. The individual has difficulty understanding the proceedings or presenting their own case. This criterion protects vulnerable defendants. It includes individuals with mental health conditions, significant learning disabilities, or those who are very young. Their inability to participate effectively in their own trial makes representation essential for a fair process.

   **Example**: A 17-year-old is charged with robbery. He has a diagnosed learning disability that affects his ability to process complex information and communicate under pressure. It would be fundamentally unfair for him to represent himself.

5. The case is so complex, either factually or legally, that it is in the interests of justice for the individual to be represented. This is a catch-all criterion for cases that are simply too difficult for a layperson to handle. This could involve large volumes of evidence, complex expert evidence (e.g., financial or forensic), or multiple defendants.

   **Example**: A fraud case involving thousands of pages of financial documents and several co-defendants. It would be impossible for an unrepresented person to manage.

### The Interaction with the Means Test

It is vital to remember that passing the Interests of Justice test is only one half of the equation. An applicant must also satisfy the means test.

For magistrates' court cases, this is a strict pass/fail test based on income and outgoings. For Crown Court cases, all defendants are automatically passed on the Interests of Justice test (as the charges are always serious), but they are subject to a more detailed means test. Those with sufficient means will be required to make contributions towards their legal costs, and may have to pay them back in full if they are convicted.

***R (on the application of Gideon) v Lord Chancellor*** [2023] EWHC 464 (Admin) is a powerful modern example of the test in action. The claimant, who faced extradition proceedings, was refused legal aid. The court quashed the decision, finding that the Legal Aid Agency had failed to properly apply the "Interests of Justice" test.

The court emphasised that the decision-maker must conduct a proper, individualised assessment of the defendant's ability to represent themselves, considering the specific complexities of their case, rather than applying a general rule. The case reinforced that the right to a fair trial can require the provision of publicly funded legal representation.

In practice, for any offence that carries the possibility of a prison sentence, the Interests of Justice test is almost a formality. The system operates on the understanding that it is a fundamental requirement of a fair justice system.

For a solicitor, understanding this test is about more than just securing funding; it is about upholding the principle that everyone, regardless of their means or the allegations against them, deserves a fair fight in court. It is the mechanism that gives life to the promise that the state will not use its immense power to crush an individual who stands alone.

## 9.4 The Scope of Legal Aid

The scope of legal aid is its legal boundary. It defines the exact types of cases and legal problems for which public funding is available. Following the *Legal Aid, Sentencing and Punishment of Offenders Act 2012* (LASPO), this boundary was dramatically redrawn. The old system, where legal aid was available for most areas of law unless specifically excluded, was replaced by a new, restrictive principle: legal aid is only available for the specific types of cases that are explicitly listed in the Act and its accompanying schedules.

If a case is not on this list, it is "out of scope," and legal aid will be refused, regardless of how poor the client is or how strong their case may be. For a solicitor, knowing this list is a fundamental and first-step skill in accessing justice for clients.

### The "In Scope" List: A Lifeline in Specific Crisis

Legal aid is now primarily reserved for cases where people's most fundamental rights are at immediate risk: their liberty, their safety, their home, and their family life. The following are the key areas that remain within scope.

1. **Family Law: Protecting the Vulnerable**

Legal aid in family law is now heavily focused on situations involving abuse, coercion, or the protection of children.

**Domestic abuse**: A victim of domestic abuse can get legal aid for a range of family court orders, such as non-molestation orders (to stop harassment/violence) and occupation orders (to regulate who can live in the family home). Crucially, the client must provide specific evidence of the abuse, such as a referral to a refuge, a conviction against the abuser, or a letter from a healthcare professional.

**Child protection** (Public law): Legal aid is always available for parents and children who are involved in care proceedings or supervision orders where a local authority is seeking to take a child into care. The stakes here, the potential permanent removal of a child, are so high that representation is considered essential.

**Forced marriage & Female Genital Mutilation** (FGM): Legal aid is available for applications for protection orders in these specific, serious circumstances.

2. **Housing Law: Preventing Homelessness and Serious Harm**

Legal aid for housing is not available for general landlord-tenant disputes. It is focused on keeping a roof over someone's head or ensuring that roof is safe.

**Homelessness**: Legal aid is available to challenge a local authority's decision on someone's homelessness application, for example, if they have been found "intentionally homeless" and denied support.

**Eviction defence**: It is available to defend possession proceedings (eviction) in court where the person's home is at risk.

**Serious disrepair**: It is available to take action against a landlord where the property has serious health and safety hazards, such as severe damp, mould, or structural issues, but generally only where there is a serious risk to the health and safety of the occupant.

***R (Gudanaviciene) v The Director of Legal Aid Casework*** [2014] EWCA Civ 1622 was a key case that challenged the narrowness of the LASPO scope. The court held that, even if a case falls outside the strict scope, there remains a residual power to grant funding where a failure to do so would breach an individual's rights under the *European Convention on Human Rights* (*ECHR*), particularly the right to a fair trial (*Article 6*) or the right to respect for private and family life (*Article 8*). This provides a vital, though often difficult to obtain, safety net.

### 3. Mental Health Law: A Voice for the Detained

Individuals who are detained ("sectioned") under the *Mental Health Act* have a right to legally aided representation to challenge their detention before a Mental Health Tribunal. This ensures that those who are at their most vulnerable and whose liberty has been removed by the state have an independent advocate.

### 4. Debt and Welfare Benefits: When the Home is at Risk

Legal aid is very limited in these areas but remains available in specific, high-stakes scenarios.

**Debt**: It is available where a person's home is at immediate risk, for example, in defending a possession claim due to mortgage arrears.

**Welfare benefits**: It is generally not available for challenging benefit decisions at the First-tier Tribunal. However, it is available for appeals to the Upper Tribunal and higher courts on a point of law.

### 5. Clinical Negligence: A Narrow Exception

Most clinical negligence claims are out of scope. The only major exception is for claims relating to significant neurological injury to a baby caused by problems during pregnancy, childbirth, or in the immediate post-natal period.

### 6. Immigration and Asylum

**Asylum**: Legal aid remains available for asylum seekers making their initial claim and for appeals.

**Immigration detention**: It is available for those detained under immigration powers.

**Victims of trafficking**: It is available for individuals who have been trafficked to the UK.

Most other immigration matters, such as applications based on family life, are out of scope.

## The "Out of Scope" Wasteland: Common Legal Problems with No Funding

To understand the impact of LASPO, it is equally important to know what is no longer covered. These are areas where individuals, no matter how poor or deserving, must pay privately, find pro bono (free) help, or represent themselves.

- **The vast majority of private family law**: This is one of the most significant changes. Divorce and financial settlements are out of scope. So are disputes between parents about child contact (who the child lives with or spends time with), unless there is proven evidence of domestic abuse or child abuse. This has led to a huge increase in litigants in person in the family courts.
- **Employment law**: If you are unfairly dismissed or discriminated against at work, you cannot get legal aid to bring a claim in an employment tribunal.
- **Most personal injury claims**: If you are injured in an accident that was someone else's fault, you cannot get legal aid to bring a claim. These cases are now almost exclusively funded by Conditional Fee Agreements ("no win, no fee").
- **Most housing disputes**: Legal aid is not available for disrepair that is merely inconvenient (e.g., a broken boiler for a short period), for defending a possession claim where there is no defence, or for disputes with a neighbour.
- **Tort and general contract law**: If you have a dispute over a contract or have been the victim of a civil wrong (a "tort") that doesn't involve personal injury, it is out of scope.

## 9.5 Conclusion

The legal aid system has been dramatically narrowed. It now only covers the most serious cases where a person's basic rights to liberty, safety, or shelter are under direct threat.

To get legal aid, you must pass two strict checks; a financial check (means test) and a case merit check (for civil issues) or an "Interests of Justice" test (for criminal matters).

This means many areas of law, such as private family or housing disputes, are no longer covered. Solicitors now play a vital role as navigators, helping clients within these tight limits and guiding them to represent themselves when no funding is available.

# 10

# THIRD-PARTY AND INSURANCE FUNDING

The cost of pursuing legal rights, particularly in complex litigation, can be prohibitively expensive, creating a significant barrier to justice. Beyond traditional private payment and public legal aid, a sophisticated market has developed to provide alternative funding solutions. These mechanisms shift or manage the financial risks of litigation, enabling claims to be brought that might otherwise be abandoned. This chapter examines these key alternatives. We will explore the role of third-party litigation funders, who invest in claims in return for a share of the damages. We will then analyse the two main types of legal expenses insurance: Before-the-Event (BTE) insurance, often attached to household or motor policies, and After-the-Event (ATE) insurance, specifically purchased to cover an opponent's costs if a case is lost.

Understanding these funding streams is essential for any solicitor practising in contentious areas, as they directly impact a client's ability to litigate and engage core duties regarding properly funding legal services.

## 10.1 Third-Party Funding (Litigation Funding): Principles and Ethical Considerations

Third-Party Funding (TPF), or litigation funding, involves a professional commercial funder who is not a party to the dispute, agreeing to finance some or all of a claimant's legal costs. In return, the funder receives a pre-agreed share of the damages if the claim is successful. If the claim fails, the funder loses the money it has advanced. This is not a loan; it is a non-recourse investment in the outcome of the litigation.

### How it Works

A claimant with a strong, high-value claim but insufficient funds to pay for expert reports, court fees, and legal fees approaches a litigation funder. The funder conducts rigorous due diligence on the merits of the case. If satisfied, they enter into a funding agreement that covers the claimant's legal costs and disbursements. In exchange, the funder's return might be a multiple of the costs invested (e.g., three times the funding) or a percentage of the damages recovered (e.g., 20-40%).

### Principles and Typical Use Cases

- **Commercial claims**: TPF is most common in high-value commercial litigation and international arbitration, where claims can involve millions of pounds.
- **Merits-based**: Funders only invest in cases with a high probability of success and a defendant with the clear ability to pay a substantial damages award.
- **Asset tracing**: It can be used to fund claims to recover assets, such as in fraud or breach of fiduciary duty cases.

### Ethical Considerations and Solicitor's Duties

1. **Maintenance and champerty**: Historically, third parties meddling in litigation (maintenance) and funding it in return for a share of the proceeds (champerty) were criminal offences and torts. While the modern judiciary has accepted the legitimate role of professional funders, the old doctrines still inform the ethical boundaries. The funding agreement must not give the funder excessive control over the litigation or allow it to interfere with the solicitor's professional judgment and duty to the client.

2. **SRA principles**: Solicitors must ensure the funding arrangement does not create a conflict of interest (*Principle 7*). They must maintain their independence (*Principle 3*) and not allow the funder to dictate legal strategy. The solicitor's primary duty is always to the client.

3. **Confidentiality**: The solicitor must manage the disclosure of confidential information to the funder during the due diligence process, typically through a carefully drafted non-disclosure agreement.

***Arkin v Borchard Lines Ltd & Ors*** [2005] EWCA Civ 655 was a landmark case that provided a model for how third-party funding should operate. The Court of Appeal accepted the legitimacy of professional funding but sought to balance it by limiting the funder's liability for adverse costs to the amount of funding it had actually provided. This "Arkin cap" provided a level of comfort for both funders and claimants.

## 10.2 Before-the-Event (BTE) Legal Expenses Insurance

Before-the-Event (BTE) insurance is a pre-existing insurance policy that covers the policyholder's potential legal costs. It is often sold as an add-on to other insurance products, most commonly household contents or motor insurance policies. Many individuals possess BTE insurance without realising it.

### How it Works

A client faces a legal dispute, such as a neighbour dispute, employment issue, or personal injury claim. They, or their solicitor, check their existing insurance policies and discover they have BTE cover. The client notifies the BTE insurer, who will then assess the claim.

### The Claims Process

1. The BTE insurer has the right to select the solicitor who will handle the claim, often from a panel of approved law firms.
2. The client typically has the right to choose their own solicitor, but may have to pay any difference in costs if their chosen solicitor's fees are higher than the insurer's panel rates.

### Key Features and Solicitor's Role

**Proactive checking**: A solicitor's first step with any new client should be to ask if they have any relevant BTE insurance. Failing to do so could be a breach of the SRA's duty to act in the client's best interests (*Principle 7*) by causing them to incur unnecessary personal cost.

**Scope of cover**: BTE policies have specific limits on the amount they will pay and the types of legal disputes they cover. The solicitor must check the policy wording carefully.

**Duty to the insurer**: When acting under a BTE policy, the solicitor may have contractual duties to the insurer as well as professional duties to the client. Managing this potential conflict is crucial.

***Giles v Thompson*** [1994] 1 AC 142, while concerning hire car provision, helped establish the principle that using a pre-existing contractual right (like an insurance policy) to gain access to legal services was not an abuse of process. This legitimised the use of BTE insurance in litigation.

## 10.3 After-the-Event (ATE) Insurance: Covering Adverse Costs

After-the-Event (ATE) insurance is a policy specifically taken out after a dispute has arisen to cover the risk of having to pay the opponent's legal costs (adverse costs) and the client's own disbursements if the case is lost. It is a key component of the conditional fee agreement (CFA) ecosystem.

### How it Works

A claimant (or sometimes a defendant) decides to pursue a claim. Recognizing that they could be liable for tens or hundreds of thousands of pounds in adverse costs if they lose, they purchase an ATE insurance policy. The premium for this policy is often deferred and contingent on success, meaning it is only paid if the client wins the case.

### The LASPO Reforms and Recoverability

**Pre-LASPO**: Before April 2013, the ATE insurance premium was generally recoverable from the losing party.

**Post-LASPO**: The Legal Aid, Sentencing and Punishment of Offenders Act 2012 fundamentally changed this. For CFAs and ATE policies entered into after 1 April 2013, the ATE premium is no longer recoverable from the losing party. Instead, it must be paid by the client, usually out of their damages.

**Current Application and Importance**

**Clinical negligence**: An exception was carved out for clinical negligence cases, where the ATE premium for covering the cost of expert medical reports remains recoverable from the defendant.

**Remaining vital**: Despite the loss of recoverability, ATE insurance remains a crucial product. It provides clients with the security to bring meritorious claims without the fear of financial ruin. For solicitors, it is a key tool in constructing a viable funding package for a client.

**Solicitor's duty**: The solicitor must clearly explain the nature and cost of the ATE premium to the client, ensuring they understand that it will be deducted from their damages if they win. This is a core part of the transparency requirements under the SRA Code of Conduct.

## 10.4 Conclusion

Third-party and insurance funding mechanisms are integral to the modern litigation landscape. They democratise access to justice by managing and transferring risk. For the solicitor, navigating this terrain requires a sophisticated understanding of both the financial products and the profound ethical duties they engage, ensuring that the pursuit of a client's claim is not only legally sound but also financially viable and properly funded.

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