

# Professional hotchpotch

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The professional 'Big Bang' ignited by the Legal Services Act will herald the emergence of new combinations of professionals. Financial advisers will be key participants in the multi-disciplinary mix, says Ian Muirhead

The Legal Services Act of 2007, which is scheduled to come fully into effect during 2011, was designed to address two main issues:

- The first is the contention of the Office of Fair Trading (OFT) that the solicitors' closed shop, which prohibits solicitors from practising in combination with non-solicitors, is anti-competitive.

- The second issue is the Law Society's ambivalent role in acting both as the representative body and the regulator of solicitors. Addressing this second issue, the Law Society has already voluntarily hived off its regulatory function to the Solicitors' Regulation Authority. However, more significantly, reflecting the fact that solicitors may in future be minority participants in firms controlled by other professionals, the Act has created a new overlord legal regulator, the Legal Services Board, charged with regulating such professional bodies as may apply to it for recognition.

The SRA will clearly remain the principal regulator for legal business, but it is highly significant that, among those who have signalled their intention to apply for recognition, are a number of accountancy bodies.

## Alternative business models

The Act opens the door to three main alternative business structures (ABSs).

The first ABS variant is the multi-disciplinary practice (MDP), ie, a combination of professional disciplines within a single firm. As an interim measure, the Act now permits the formation of legal disciplinary practices (LDPs) comprising at least 75% lawyers (ie, solicitors, barristers, trade mark agents etc) and up to 25% non-lawyers. However, this model has not so far been used as a vehicle for non-legal services.

The full MDP model will be available in 2011 and will permit participation by any combination of professionals, subject to a 'fit and proper' test, provided that at least one lawyer is included. However, the mixed firm concept may be a slow burn because, apart from cultural differences, there are unresolved issues over the special safeguards afforded to solicitors' client information and the disparity between the various professional compensation and indemnity schemes. For example, the solicitors' compensation scheme offers £2m and the FSCS only £50,000.

Consequently, other forms of combination seem likely – for example the hub and spoke model, whereby a group of professional firms might combine to share administrative, systems, compliance, marketing services and perhaps branding, while retaining their individual autonomy.

The second main variant of ABS is the so-called Tesco Law, whereby a commercial organisation establishes a ring fenced law firm subsidiary, which may or may not have a synergetic relationship with another part of the organisation. This model is likely to become a principal conduit for those legal services that can be commoditised, with consequent cost savings to the consumer. Tesco, the AA and the Co-op all plan to enter this market.

The third ABS variant is public ownership of law firms, and in this respect venture capital involvement and AIM listings are likely to be on the agenda for some larger firms, particularly in relation to personal injury work. Consolidation will be one of the drivers, and the view is that law firms can be made more efficient and profitable if they are run by businesspeople.

## Solicitors' vulnerability

The prospect of increased competition, coinciding with a recession that has cut swathes through the legal profession, has shaken many solicitors out of the complacency of which they have been accused. An Intendance survey in 2008 found that 60% of solicitors thought that high street law firms will be a "rarity" by 2015, and professor Stephen Mayson, the leading legal academic, has predicted that 3,000 law firms – one third of the present number – will fail.

The lower end of the legal market is likely to be hit particularly severely, and there is an acceptance that many of the services currently provided by solicitors will be able to be undertaken more cheaply by non-solicitors.

The situation is exacerbated by the fact that there is a surfeit of solicitors. The number has doubled over the past 20 years and the Law Society has recently been obliged to issue an announcement advising would-be trainee solicitors to consider a different career.

Solicitors' Achilles heel is that many are too dependent on transactional business and do not maintain a sufficiently regular contact with their clients. In November 2009 the Law Society Gazette reported on research showing that 66% of clients who had used a solicitor had never heard from them again. As the managing partner of law firm Trethowan's commented, "Law in many instances is seen as a distress purchase. Generally, clients try to avoid spending any money on legal services unless they have to."

In addition, many solicitors are poor business managers. As the law management section of the Law Society concluded in a 2009 report: "Perhaps the main requirement for all of these [structural] options will be good and well developed management and skills only found in a minority of firms at present".

### **What about financial services?**

The flip side of every challenge is an opportunity, although for solicitors the challenges seem to outweigh the opportunities. However, they are now receptive, to an unprecedented extent, to alliances with other professionals.

For medical negligence firms this may mean aligning with doctors. For commercial firms, trademark and patent agents might be a good fit. Litigation firms are likely to take on barristers. But for private client firms, financial advice is the natural complement to legal work, enabling solicitors to offer a more comprehensive service and to maintain regular contact with their clients.

Ideally, financial services might be provided inhouse, but in practice solicitors have made a poor fist of this option. Of 420 law firms originally authorised by the FSA, fewer than 70 remain. This is ironic, because authorised professional firms enjoy the considerable advantages of being exempt from the FSA's capital adequacy requirements and from the FSCS. The problem has been solicitors' inability to manage non-mainstream businesses.

A notable caveat to this generalisation is the highly successful Edinburgh firm of Turcan Connell, which comprises 75% solicitors and 25% financial planners and asset managers, and has rebranded itself as a family office. However, Scottish solicitors are more instinctively enterprising than their English counterparts and have the benefit of the close historical association between legal and financial communities.

The accountants, also, have been able to show English solicitors a clean pair of heels and there are now over 800 accountancy related IFA firms. In many cases they have hived off their financial services activities into separate units in which the accountants retain a stake but the financial advisers have free rein to run their own businesses.

Paul Willans, CEO of Mazars Financial Planning, having worked in both legal and accountancy firms, summarised neatly the difference between the two when he commented that, in law firms, everything is done in Word whereas in accountancy firms everything is done in Excel.

The conclusion may be drawn that IFA business is not best conducted as a minority element in a firm dominated by other professionals. This being the case, it seems likely that the main interaction between solicitors and IFAs will in future be via strategic alliances, whether in the form of client referrals, joint ventures or, ultimately, hub and spoke or similar ABS structures.

### **From referral to joint venture**

The starting point of a relationship is likely to be a referral arrangement. However, many solicitors are wary of IFAs bearing gifts, having been assailed over the years by approaches from all and sundry financial advisers whose suitability they have often been unable to judge.

This has prompted the SRA recently to issue guidance reiterating the principle that referrals must not be made to tied or multi tied organisations and that solicitors may only retain commissions if they can demonstrate that it is in their clients' best interests for them to do so.

The main purpose of the SIFA directory of professional financial advisers, which has been endorsed by the Law Society and is accessible online via the Society's website, is to assist solicitors to identify RDR compliant IFAs who will make suitable business partners.

What solicitors are increasingly seeking in an IFA relationship is a professional service that will complement their own and reflect well on them, assisting them to maintain contact with their clients and perhaps resulting in reciprocal business.

Somewhat to their surprise, some solicitors are also finding that IFAs, having been through the FSA's TCF learning curve, are well placed to share their experience of fact finding procedures, database management, client segmentation, management information analysis and client communications. Working together on these issues provides the ideal platform for business relations.

Joint ventures (JVs) have become an increasingly popular model and enable solicitors to delegate responsibility for compliance and management to their IFA associates while benefiting financially in a way that the referral relationship does not permit.

Typically, the JV will be an appointed representative of the IFA firm, which will also provide the staffing and administration, so that the solicitors' role is confined to referring clients and providing a professional overview. The IFA firm will levy a management charge and the balance of the available revenue will be applied to fund dividends, for which the solicitors will not be required to account to their clients provided that the JV works on a purely fee basis.

An early example of the JV was the company established by accountancy-based PB Financial Planning and solicitors Kester Cunningham John in East Anglia, under the name of Kester Cunningham John Financial Planning. In Scotland, accountancy based IFA Scott-Moncrieff has a similar venture with Edinburgh solicitors Lindsay's.

An alternative to the JV between a single IFA firm and a single solicitor firm is the multiple joint venture, of which the most recently launched was Professional Financial Centre (East Midlands), which aims to act as a common financial planning resource for professional firms in its area.

### **Way forward**

Whatever structural form the relationship between IFAs and solicitors might take, IFAs need to distinguish themselves from their competitors by aligning their skills to solicitors' specialisations. Typical examples are investment for trusts and Court of Protection, with associated cash flow planning; pensions and divorce and collaborative law; advice to the elderly; and financial solutions for estate planning. Solicitors' own needs can also be addressed, particularly in areas such as pensions.

Solicitors possess valuable assets in their professional standing, their technical knowledge and their client banks, but they lack the commercial and client skills that IFAs have to offer. By working closely together solicitors and IFAs can enhance the service that they provide to their clients for the benefit of all.

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