

## **Guidance**

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### **Status**

This guidance does not form part of our Standards and Regulations. However, we will have regard to it when exercising our regulatory functions.

### **Who is this guidance for?**

All licensed bodies (also known as ABSs) that we regulate and all those who intend to acquire an interest in a licensed body.

### **Purpose of this guidance**

This guidance is to help you understand our approach in determining whether or not a person's interest in a licensed body requires notification to us, and approval by us, under Schedule 13 to the Legal Services Act 2007 (LSA).

Under the LSA, we must approve the holding of a material interest in a licensed body by any non-authorised person. What we mean by 'material interest' is detailed later in this guidance.

This guidance is intended to facilitate understanding of our approach in this area and should not be relied upon or interpreted as advice on the law. Licensed bodies, those seeking licensing, and those involved with such bodies, should take care to satisfy themselves of their legal obligations under Schedule 13 as a failure to meet the requirements of the LSA could result in a criminal offence being committed.

### **Authorised persons and non-authorised persons**

Although only non-authorised persons require approval under the LSA, our own rules require anyone holding a material interest in a licensed



body to have approval from us.

Authorised persons are those who are authorised by a legal regulator (an approved regulator under the LSA) to undertake one or more reserved legal activities. Essentially, it includes lawyers of England and Wales entitled to practise as such, registered European lawyers, and regulated law firms. Note that, since 1 January 2021, only a defined group of Swiss lawyers can be registered European lawyers.

Non-authorised persons include any person (including bodies, whether corporate or unincorporated) who is **not** one of the following:

- an authorised person (see the summary above)
- a registered foreign lawyer
- an advocate or solicitor in Scotland
- a member of the Bar of Northern Ireland or a solicitor of the Court of Judicature of Northern Ireland
- a legally qualified body (see the SRA Glossary for the definition of what constitutes a legally qualified body).

The definitions of ‘authorised’ and ‘non-authorised’ persons are technical. The terms ‘lawyer’ and ‘non-lawyer’ are commonly used for simplicity. Care should be taken though as lawyers or law firms outside of the UK will not generally come under the definition of ‘authorised persons’.

## **Requirement to be approved**

Rule 9.1 of the Authorisation of Firms Rules requires that any owner of an authorised body is approved by us.

We define an owner as being a partner in a partnership (as defined by our Glossary), or any person who holds a material interest in the body. Material interest is defined to mean the same as it does under Schedule 13, and we describe that in more detail below.

In all cases, an application for approval should be made, and approval granted, before a person becomes an owner. However, for non-authorised owners in licensed bodies, there are additional statutory requirements, as follows:

- There is a legal obligation to notify us of the proposed holding of a material interest and a criminal offence may be committed if this is not done.
- The holding of that ownership interest by the person in question will need to be approved by us **before** the interest is acquired (except in limited circumstances where the interest was acquired unexpectedly, for example, by inheritance).
- We may refuse to approve the ownership interest (called an objection) or impose conditions upon the holding of that ownership



interest.

- We may withdraw approval of the holding of the interest or impose conditions at a later date.
- We may take action to enforce conditions or remove the material interest from a person in certain circumstances.

## **A note on terminology**

The LSA and Schedule 13 refer to four types of interest – notifiable, restricted, material, and controlled. These terms have the potential to mean different things depending on the licensing rules set by the regulator. In summary:

- Material and controlled interests – these are interests determined by the amount of interest a person holds. Controlled interests only exist where provision has been made in the licensing rules for them. We have not made any such rules so we are only concerned with material interests (see below).
- Restricted interest – this term essentially refers to interests which require approval, and therefore encompasses both material and controlled interests. As we have not made provision for controlled interests, reference to a restricted interest means the same thing as a material interest under our rules.
- Notifiable interests – as all restricted interests require approval, a new restricted interest is a notifiable interest and must be notified to the licensing authority so approval can be considered.

Accordingly, any reference to a notifiable, restricted or material interest means the same thing under our rules and procedures. For simplicity, we only use the terms ‘material interest holder’ when referring to relevant provisions under the LSA or ‘owner’ under our own rules and regulations.

## **Assessing a material interest**

Paragraph 3 of Schedule 13 sets out the tests for assessing at which point an interest becomes material and therefore requires our approval.

As bodies operate under many different business structures, the tests provide for a variety of methods for calculating at what point an interest becomes material in different types of firm and structure.

In summary, the tests set out in paragraph 3 of Schedule 13 look at:

- Those who hold 10% or more shares in the licensed body (the term ‘shares’ has a wide meaning and that is discussed below) or any parent undertaking of the body.
- Those who exercise, or control the exercise of, voting power in the licensed body or any parent undertaking which, if it consists of voting rights, constitutes at least 10% of the voting rights.



- Those who can exercise significant influence over the management of the licensed body, or any parent of it, as a result of their shareholding, voting rights or voting power.

If any one of those tests is met, a person will hold a material interest.

## **What do we mean by shares?**

Traditionally, people think of shares as meaning the shares issued by a company. However, the LSA applies a much broader definition so the same material interest test can be applied, for example, to partnerships and limited liability partnerships (LLPs).

Under the LSA, holding shares means:

- For bodies with share capital (most companies), allotted shares.
- For bodies with capital but no share capital (quite common in LLPs), rights to share in the capital of the body.
- For bodies without capital (common in smaller partnerships):
  - rights to share in the profits, or liability to contribute to the losses, of the body, or
  - giving rise to an obligation to contribute to the debts or expenses of the body in the event of a winding up.

Bodies with capital may have that capital by way of cash contributions made by the members or partners of the firm. A person has a share in that body under the LSA if they have a right to share in that capital. Any rights to share in an increase in the value of the capital while a body remains trading, and any rights to share in surplus assets on winding up, will also constitute a right to share in the capital of a body.

So, for example, in a body with capital, a partner or member that is entitled to 10% of the proceeds of the sale of the business assets if the business is wound up would be a material interest holder.

Bodies without capital might be funded by a mixture of bank borrowings and retained profits. In such cases, a partner or member that is entitled to share in 10% or more of the profits, or is liable to contribute to 10% or more of the losses, would be a material interest holder.

For any body without allotted shares, determining who holds shares can usually be ascertained from the partnership or LLP agreement (or equivalent). However, this may be determined as a matter of law. For example, section 24(1) of the Partnership Act 1890 provides that, subject to any agreement to the contrary, partners are equally entitled to share in the capital and profits of a business and also must contribute equally towards losses. That means in a partnership where no agreement exists, and there are 10 or less partners, all partners will be material interest holders.



## **What do we mean by voting power?**

The LSA provides that, under Schedule 13, 'voting power' applies in relation to a body which does not have general meetings at which matters are decided by the exercise of voting rights. In those cases, voting power means the right under the constitution of the body to direct the overall policy of the body or alter the terms of its constitution.

The constitution of the body is not limited to articles and memoranda of association in a company or the partnership and membership agreements in a partnership or LLP. It is our view that the constitution of a body could also include other documentation, resolutions, procedures or practices which govern rights, responsibilities and decision making within the business.

The LSA does not define what is meant by directing overall policy. It is our view that this includes directions relating to:

- setting the objectives of the business
- setting the strategy of the business
- distribution of capital, profits or other income
- changing the name of the firm
- the addition and removal of managers
- the sale of significant assets (relative to the business in question), or
- incurring significant debt (relative to the business in question).

Usually, voting rights exist in companies, while voting power usually applies in other types of bodies (partnerships, LLPs, associations etc). However, voting power may apply in companies where, for example, they do not hold general meetings and the power to direct the overall policy of the body lies with the directors themselves.

Unlike voting rights, the LSA does not require that a particular percentage of the voting power must be exercised or controlled by the person in order for the interest to be material. However, in accordance with the spirit and intention of the LSA, we will usually assess voting power on a similar 10% threshold.

## **What do we mean by significant influence?**

'Significant influence' over the management of a body is not defined but is linked to some form of share interest or voting rights.

Significant influence over the management of a body could take many different forms.

In most instances, those who have 'significant influence' will also satisfy one of the other tests for assessing whether a material interest exists. However, this will not always be the case. For example, a non-authorised



person might hold less than 10 per cent of the voting rights in a licensed body which is a company but, under a shareholder's agreement, have a power of veto over important decisions in the business or some other form of preference.

In all cases we will look at the evidence as to how the business is managed in practice and the rights the person has within the constitution of the body.

## **What do we mean by a parent undertaking?**

A parent undertaking under the LSA has the same meaning as that given by section 420 of the Financial Services and Markets Act 2000, which itself applies the meaning under section 1162 of the Companies Act 2006. In summary, a parent undertaking is one which:

- holds a majority of the voting rights in an undertaking, or
- is a member of the undertaking and has the right to appoint or remove a majority of its board of directors, or
- has the right to exercise a dominant influence over the undertaking by virtue of provisions in the undertaking's articles, or by virtue of a control contract, or
- is a member of the undertaking and controls alone, under an agreement with other shareholders or members, a majority of the voting rights in the undertaking.

A parent undertaking will be a parent undertaking not only of its own subsidiary, but also of any subsidiaries of which that subsidiary undertaking is itself a parent.

## **Associates**

Where two or more associated non-authorised persons hold shares, voting rights, or voting power in the same body, their interests will be assessed together. If the combined interest is material, they will all constitute material interest holders.

The 'associates test' is intended to address the scenario where two non-authorised persons may act together to influence or control a licensed body. In those circumstances, the LSA requires a joint assessment of the interests held by those persons.

Persons who are associated with each other are:

- spouses or civil partners
- children / stepchildren (under 18) and their parents
- trustees and beneficiaries of any settlement under which the beneficiary has a life interest in possession (in Scotland a life interest)



- undertakings and their directors, their subsidiaries, or directors or employees of a subsidiary
- employers and employees
- partners in a partnership other than the one in which the interest is being assessed
- those who have agreements or arrangements with each other with respect to the acquisition, holding or disposal of shares or other interests in the body concerned
- those who have agreements or arrangements under which they undertake to act together in exercising their voting power in relation to the body concerned

For example, if a non-authorised husband and wife each hold 5% of shares in a body, they must be assessed together, and they would each be considered to have a material interest of 10%.

However, in the scenario above, if the wife was a lawyer, we would not combine the interests for assessment, and both would be treated independently as holding a non-material interest.

## **The material interest test - summary**

In order to assess who holds a material interest, and therefore requires approval, you need to consider the following:

- How are shares defined for the body concerned and who holds those?
- Are decisions in the body controlled by voting rights or voting power, and who exercises those or controls the exercise of those?
- Is there anyone who may have significant influence over the management of the body by virtue of their shareholding or voting rights?
- Are any non-authorised persons who holds shares, voting rights or voting power in the body associated with any other non-authorised persons who also hold shares, voting rights or voting power in the same body?
- Are there any parent undertakings? If so, you need to assess the same information at (a) to (d) above for those parent undertakings.

Anyone (whether an individual or a body) who is assessed as holding 10% of the shares, voting rights or voting power (alone or by association), or having significant influence, requires our approval.

## **Next steps**

If you wish to apply for approval, please go to our [Firm-based authorisation webpage](https://upgrade.sra.org.uk/solicitors/firm-based-authorisation/existing-firms-applications/approval-manager-owner/) [https://upgrade.sra.org.uk/solicitors/firm-based-authorisation/existing-firms-applications/approval-manager-owner/] where you will find all the necessary applications forms, along with details of timescales.

## Further help

If you require further assistance, please contact the [Professional Ethics helpline](https://upgrade.sra.org.uk/contactus) [<https://upgrade.sra.org.uk/contactus>].