LEGAL SERVICES BOARD

Wider Access, Better Value, Strong Protection

Discussion paper on developing a regulatory regime for alternative business structures

This consultation will close on **14 August 2009**

Contents

1. Executive summary

1.1. This discussion paper is an important step towards a liberalised, more consumer-driven market for legal services.

1.2. For centuries, legislation and professional regulatory rules have tightly restricted the management, ownership and financing of organisations that are permitted to offer legal services. Although the UK's legal services sector is internationally competitive and highly regarded, these regulatory restrictions have stopped it from realising its full potential. Regulation has limited innovation and competition in the way that legal services are delivered. It has constrained consumer choice and restrained normal market pressures on law practices to deliver their services efficiently and effectively. Regulation has gone beyond what is rightly necessary to protect citizens from the unethical practices of a tiny minority to a framework which has restricted businesses and consumers alike.

1.3. At the heart of the new regulatory environment for legal services is a process for scaling back these restrictions. Each of the approved regulators of the legal profession can become a licensing authority, able to grant licences to new types of providers with alternative business structures ("ABS"). The new types of firm might include a practice with a majority of non-lawyer managers, a high-street firm offering accountancy services alongside legal services, a large corporate firm offering personal client advisory work alongside larger scale work, in areas such as personal injury, which may be susceptible to "commoditisation" or even a law firm floated on a stock exchange.

1.4. As the new body responsible for overseeing the regulation of legal services in England and Wales, the Legal Service Board ("LSB") is committed to driving this agenda forward, because it potentially offers considerable benefits to consumers of legal services, be they private individuals or organisations of all shapes and sizes. We cannot predict precisely how the market will develop so we are keen to receive input from market participants. But we anticipate greater flexibility in service delivery, including better use of new technology; more effective use of staff from a variety of professional backgrounds; and firms seeking to

better inform and engage with the users of their services as they seek to build loyalty and reputation in the marketplace.

1.5. We also foresee benefits for individual lawyers and firms that embrace new opportunities that a more competitive market place offers. The difficulties faced by parts of the sector in the current economic downturn adds to our conviction that modernisation of the restrictive regulatory framework is timely.

1.6. So we have moved beyond the debate about *whether* to open up the market to ABS. That was settled when the Legal Services Act 2007 ("The Act") was passed by Parliament. Instead, this paper sets out plans for *when* and *how* the market will be opened. It also seeks comments from stakeholders about how the new types of legal services providers should be regulated.

1.7. Our timetable for opening the market makes clear our objective that the first ABS licences should be granted in mid-2011. There is much work to be done to achieve this ambition. Getting a new licensing framework in place will require sustained commitment and focus from a number of stakeholders. But we are convinced that it is achievable. We will give this matter high priority and we expect the approved regulators will do the same, given our shared statutory objectives. We will set up a high-level ABS Implementation Group which will bring together these key players and others to maintain momentum and foster a partnership approach to the development of the regime.

1.8. The LSB is primarily an oversight regulator with backstop direct licensing powers. We expect and hope that a number of approved regulators will seek to become licensing authorities and we will do what we can to facilitate that. By 2011 a regulatory landscape should be in place which offers different types of firm the opportunity to apply for a licence. However, as the LSB cannot be certain that will be the case, it will also make preparations to take on the responsibility of directly licensing firms with ABS if it proves necessary. We plan to issue our own licensing rules in the first half of 2011 if that is what is needed to deliver our ambition of a mid-2011 start date for ABS licensing.

1.9. Potential licensing authorities will need to develop licensing rules to deal with the risks associated with ABS. We are determined that clients

will not have lower standards of protection using the services of licensed firms than they would if they went elsewhere in the market. Nor will licensed firms be able to ignore actual or potential conflicts of interest: to do so leaves clients unprotected and, by reducing confidence in legal services providers generally, undermines one of the LSB's regulatory objectives of upholding the rule of law.

1.10. There is a lack of clarity and consensus about the nature of the risks associated with opening the market to ABS. So this paper seeks views and evidence about the risks to the regulatory objectives from different types of ABS. It is important to ask which risks are unique to a more open market, and which are already a feature of the legal services sector today. Our initial assessment is that many risks fall into the latter category.

1.11. We are clear that regulators of ABS will need to make major changes to the way in which they regulate. A shift in focus is required, from regulating the conduct of individual lawyers, towards regulation of the entity providing legal services and we welcome recent moves in that direction made by some regulators. This will impact upon the way in which licensing rules are drafted and licensing applications assessed. But it will be of even greater significance to the way in which regulators and firms work together to ensure compliance on an ongoing basis.

1.12. There are parallels here with current debate about the future regulation of firms that provide legal services to corporate clients. We expect that regulators will want to take a joined-up approach to responding to these challenges, for example, in ensuring the right knowledge levels in staff, ensuring that relationships with large players are both challenging and well-informed and getting the right balance between a focus on principles and more detailed requirements. They need to develop an approach to regulation which is focused on the risks and is fit for purpose for the legal services landscape of tomorrow.

1.13. The Act includes considerable and important consumer protection safeguards, so we will approach calls for additional entry requirements with some caution. More detailed consultation on the content of licensing rules will follow later in 2009, but we are keen to get early input from stakeholders about the substantive issues. Ideas about how regulators can manage and mitigate identified risks associated with

ABS without erecting undue barriers to entry would be particularly helpful.

1.14. Finally, the paper starts an important discussion about the future regulation of “special bodies” including trade unions and not-for-profit organisations. These bodies are an important part of the legal services landscape and in some cases play a vital role in offering access to justice to disadvantaged consumers. Before including them in the licensing regime, we need to be clear about the nature and intensity of regulation merited by the particular risks associated with these bodies.

1.15. The deadline for written responses to this consultation is 5pm on **14 August 2009**. We urge all interested parties to respond and where possible include hard, ideally quantified, evidence. This will help us in shaping a regulatory regime which delivers wider access, better value and strong protection for consumers of legal services.

2. Background

2.1. The opening of the legal services market to new types of business structures has had a long gestation period. This section summarises the development of the policy and the legislation and places this discussion paper in context.

Development of ABS

2.2. In 2001 an Office of Fair Trading ("OFT") report[1] identified a number of anti-competitive restrictions in Law Society and Bar Council rules, including the ban on multi-disciplinary practices and partnerships between different types of lawyer. It was recognised that changes in legislation were needed to enable the Law Society to regulate non-solicitor partners. A 2003 Government report[2] expressed support for the principle that new business entities should be able to provide legal services.

2.3. The Government then commissioned Sir David Clementi to consider what regulatory framework would best promote competition, innovation and the public and consumer interest in an efficient, effective and independent legal sector. His 2004 Review[3] identified the restrictive nature of current business structures as one of his main concerns. He proposed that lawyers from different professional backgrounds should be able to practice together within Legal Disciplinary Practices ("LDPs") and that non-lawyers should also be able to be managers provided they remained in a minority. Clementi also proposed outside ownership of LDPs, subject to proper consumer protection safeguards being put in place. He regarded Multi-Disciplinary Practices ("MDPs") – within which lawyers and other professionals provide legal and other services – as a further step raising distinctive risks and regulatory challenges. So the Review recommended that LDPs should be permitted first before opening the market to MDPs.

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[1] *Competition in professions*, Office of Fair Trading (2001).
[2] *Competition and regulation in the legal services market*, Department for Constitutional Affairs (2003).
[3] *Review of the Regulatory Framework for Legal Services in England and Wales – Final Report*, Sir David Clementi (2004).

2.4. In 2005 the Government issued a White Paper[4] setting out its agenda for reforming the regulation and delivery of legal services. It anticipated potential benefits from ABS for consumers (including more choice, better access to justice and improved customer services) and legal services providers (including increased access to finance, increased flexibility and new career options for legal professionals and non-legal staff). The Government therefore proposed that lawyers and non-lawyers should be able to work together to provide legal and other services within a single ABS. External investment in these ABS would also be permitted when the regulatory framework was in place.

2.5. The White Paper proposed to introduce legislation to provide for a flexible and robust licensing regime for ABS. This was duly brought forward within Part 5 of the Legal Services Bill and was debated extensively in Parliament.

2.6. When the Bill received royal assent as the Legal Services Act 2007, the Government[5] stated that the ABS provisions, "enable greater consumer choice and flexibility in legal services by removing disproportionate restrictions on business structures, allowing lawyers and non-lawyers to set up businesses together for the first time ever, and enabling services to develop in new, consumer-friendly ways".

Legislative framework

2.7. The LSB's regulatory objectives are set out at the start of the Act and they are shared with the approved regulators:

- protecting and promoting the public interest;
- supporting the constitutional principle of the rule of law;
- improving access to justice;
- protecting and promoting the interests of consumers;
- promoting competition in the provision of services in the legal sector;
- encouraging an independent, strong, diverse and effective legal profession;
- increasing public understanding of citizens' legal rights and duties; and

[4] *The Future of Legal Services: Putting Consumers First*, Department for Constitutional Affairs (2005).
[5] *Legal Services Act given royal assent*, Ministry of Justice News Release (30 October 2007).

- promoting and maintaining adherence to the professional principles of independence and integrity: proper standards of work; observing the best interests of the client and the duty to the court; and maintaining client confidentiality.

2.8. The Act established a regime which will allow firms with ABS to apply for a licence to provide legal services. To grant licences to ABS, approved regulators will first need to be designated as licensing authorities by the Lord Chancellor, on the recommendation of the LSB. In addition, the LSB itself has backstop powers to directly grant licences to bodies that have no other competent licensing authorities to accept their applications.

2.9. The LSB will set out procedures and criteria for approved regulator applications to be designated as licensing authorities. But these applications must include the regulator's proposed licensing rules.

2.10. The licensing rules set out how the licensing authority proposes to regulate ABS. This includes not only how an application for a licence will be determined but also the ongoing regulation of the firm by the licensing authority.

2.11. Licensing rules must contain several provisions including:

- conduct, discipline and practice rules;
- how the licensing authority is to take into account the objective of improving access to justice whenever it grants a licence; and
- appropriate indemnification and compensation arrangements.

2.12. The Act also specifies another key consumer safeguard. A licensed body must have a Head of Legal Practice ("HoLP") and a Head of Finance and Administration ("HoFA") both of whom must have been approved by the licensing authority. The HoLP and HoFA ensure compliance with the terms of the licence and must report failings to the licensing authority. They must be approved by the licensing authority as "fit and proper persons" and must take all reasonable steps to ensure compliance with the terms of the licence.

2.13. Schedule 13 of the Act sets out detailed requirements on the ownership of licensed bodies. Non-lawyer owners of "restricted interests" in ABS

will need to satisfy the licensing authority that they are a "fit and proper" person to hold that interest.

2.14. The Act also facilitates a modified licensing regime for "special bodies" (including not-for-profit organisations and trade unions) to reflect the distinctive nature of these bodies relative to other providers of legal services.

2.15. The first step towards ABS was taken on 31 March 2009[6] when powers in the Act were used to introduce LDPs which can be owned by different types of lawyer and/or up to 25% non-lawyers.

Discussion paper

2.16. In our Business Plan 2009/10 we identified developing the regulatory framework to facilitate ABS as a top priority for the LSB. Opening the market to new forms of legal services provider is one of the core planks of the reform of legal service regulation and we are keen to build momentum towards that goal. So the LSB is issuing this discussion paper within a few months of being established at the beginning of 2009.

2.17. As we set out in the next chapter, such a major undertaking cannot be achieved overnight. There is much work to be done and we will be consulting again later in the year on the detail of the licensing regime for ABS.

2.18. But this discussion paper is an opportunity to air the key issues and gather evidence at an early stage. In so doing, we aim to build consensus and be in a better position to work with the regulators to get the licensing regime in place at a reasonable pace.

2.19. We are particularly keen to hear views and receive evidence about how the legal services market may develop in the years ahead as a result of the relaxation of regulatory restrictions. This will help us to understand the potential opportunities offered by ABS and the risks that will need to be managed by regulators.

[6] *Law firms to allow non-lawyer partners*, Ministry of Justice News Release (31 March 2009).

2.20. To scope the issues for the discussion paper, and to understand the perspectives of stakeholders, we arranged an extensive programme of meetings including approved regulators, law firms, professional bodies, consumer groups, not-for-profit organisations and potential investors from both the banking and private equity sectors. We have had intensive discussions with the Solicitors Regulation Authority ("SRA") and the Ministry of Justice ("MoJ") as they will be key partners in developing the ABS regime. We have also researched regulation in other sectors in the UK and learned from the Australian experience of opening up their legal services market. The College of Law's forum on External Ownership and Investment, which has brought together stakeholders to discuss the key issues in relation to ABS in recent months, has also proved very helpful to us.

2.21. Alongside this formal consultation, we will be arranging further meetings and events with stakeholders including law firms of all sizes, different groups of consumers and special bodies. We also anticipate that the Legal Services Consumer Panel (the "Consumer Panel"), to be established later this year, will be an important voice in the debates and decisions ahead. We intend to ask the Consumer Panel to identify any gaps in the evidence base and to help us in developing success measures for the ABS initiative.

How to respond

2.22. Our consultation period ends at 5pm on **Friday 14 August 2009**. In framing this consultation paper, we have posed specific questions which can be found at the end of each chapter and the full list at the Annex. We would be grateful if you would reply to those questions, as well as commenting more generally on the issues raised.

2.23. We would prefer to receive responses electronically (in Microsoft Word format), but hard copy responses by post or fax are also welcome. Responses should be sent to:

James Hutchinson
Legal Services Board
7th Floor, Victoria House
Southampton Row
London WC1B 4AD

E: consultations@LegalServicesBoard.org.uk
Fax: 020 7271 0051

3. Timeline

3.1. The introduction of a licensing and regulatory regime for ABS, which protects and promotes the needs of all consumers, will necessarily take some time. The Act establishes a number of stages in the journey. Getting to the final destination will require co-ordinated and sustained action on the part of all of the key actors, particularly the approved regulators, the MoJ and the LSB.

3.2. We are alert to calls from legal firms, individual lawyers, potential new entrants and investors for some clarity about timelines to assist with investment decisions. Most importantly, we are keen to realise the potential benefits to consumers from a market which includes ABS as soon as is practicably possible. So we have concluded that it would be helpful to set out an indicative timeline for the development of the ABS regime, and a target date for the grant of the first licence.

3.3. **The LSB is clear about its objective that the first ABS licences should be granted in mid-2011.** To be in a position to grant licences in 2011 the regulators will need to make progress on the development of their licensing rules during the remainder of 2009, and submit their applications to become a licensing authority in mid-2010.

3.4. The high-level timeline below follows preliminary discussions with the MoJ about the likely dates for commencing the LSB's powers on ABS:

14 May 2009 – Publication of this discussion paper

14 August 2009 – Deadline for responses to discussion paper

September/October 2009 – LSB issues consultations on draft procedures/criteria when considering approved regulators' applications to become licensing authorities and draft guidance to licensing authorities on content of licensing rules

Q4 2009/10 – LSB issues rules on procedures/criteria for licensing authority applications and guidance on licensing rules

Q4 2009/10 – Commencement of Schedule 10 powers allowing prospective licensing authorities to submit applications to the LSB

Q1/2 2010/11 – First applications from approved regulators to become licensing authorities

Q2 2010/11 – LSB consultation on our approach to direct licensing of ABS

Q3 2010/11 – LSB issues decision notices on first applications to become licensing authorities and makes recommendations to Lord Chancellor

Q4 2010/11 – Lord Chancellor issues Order designating first licensing authorities

Q1 2011/12 – LSB issues licensing authority policy statement and licensing rules (if necessary)

Q1 2011/12 – First provisional applications from bodies seeking an ABS licence to licensing authorities

Q1/2 2011/12 – Part 5 powers commenced permitting licensing authorities to grant licences; first ABS licence is issued

3.5. To facilitate successful implementation of the timetable, the LSB intends to issue draft guidance this autumn regarding the content of licensing rules and the process for submitting applications for licensing authority designation. We are particularly keen to hear views from approved regulators about the issues that need to be addressed by the LSB in order to achieve the timeline above, what the risks are to its achievement and how these can best be mitigated.

3.6. **Because the ABS project is such a high priority, and because it will require ongoing coordination between a number of organisations, the LSB will shortly establish a high-level, cross-stakeholder ABS Implementation Group**. The Group, to be chaired (at least initially) by our Chief Executive, will provide strategic leadership, identify critical path tasks and lead responsibilities, and monitor progress. It will build on the work of the College of Law's Forum on External Ownership and Investment, but with the focus shifted from policy debate to practical implementation and delivery. It will not make policy decisions and it will not fetter the formal decision-making role and responsibilities of the LSB including on applications from regulators to become licensing authorities.

3.7. We anticipate that the Implementation Group's membership will include members of the Consumer Panel when appointed, other consumer and business representatives, as well as approved regulators and those representing special bodies. We will take stakeholder views informally in developing its terms of reference.

3.8. In addition to this development work, we will continue to encourage approved regulators to explain as fully as they can to potential applicants how they can prepare for ABS in a way which enables early decisions, but also ensures compliance with current regulatory requirements. The development of momentum in implementation calls for maturity of approach in both potential applicants and the regulators. Regulated firms cannot and should not expect "carte blanche" to ignore current requirements. But regulators should make sure their rules and their enforcement is focused on the principle of ensuring proper consumer protection in a proportionate way, rather than seeking to enforce a uniform approach to compliance for different business models.

LSB as a Licensing Authority

3.9. The LSB is firmly committed to opening the market and facilitating new entry. So we are working closely with the approved regulators to encourage the development of a comprehensive licensing regime. We trust our commitment to making this happen as soon as is reasonably practicable is shared by others, not least because we consider that opening the market is consistent with the statutory objectives that apply to both the LSB and the approved regulators.

3.10. Once fully implemented, the Act will allow firms and special bodies ("licensable bodies") to apply for a licence from licensing authorities to enter the market and offer legal services as an ABS. We anticipate that some, if not all, of the currently approved regulators will seek to become licensing authorities, so they should be in a position to take applications from relevant licensable bodies.

3.11. We also do not discount the possibility that other bodies may seek to become approved regulators, with a view to becoming licensing authorities for ABS. We will be consulting separately on our rules on how we will determine applications for approved regulator status.

3.12. However, it is feasible that some licensable bodies may find there is no competent licensing authority available to take their application. This depends on three key factors:

- the submission of applications from approved regulators;
- the scope of reserved activities for which the regulators seek designation to grant licences;
- the decisions made by the LSB and the Lord Chancellor about these applications.

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3.13. Anticipating this possibility, Parliament included provisions in Schedule 12 of the Act to allow licensable bodies to apply directly to the LSB for a licence in certain circumstances. For example, if there is no competent (or potentially competent) licensing authority or if each potentially competent licensing authority has determined it does not have suitable regulatory arrangements.

3.14. In the event that licensable bodies are granted the right to make an application in mid-2011 and the Schedule 12 conditions are satisfied, the Act *requires* the LSB to have made suitable licensing rules and to be in a position to accept applications by mid-2012.

3.15. However, the LSB is clear that it should be willing to take on a direct licensing role early if that is what is necessary to achieve its objective of opening the market to ABS. **So the LSB is proposing that we should prepare ourselves for such an eventuality at a faster pace than is strictly *required* by the timeline set out in the Act. We plan to develop our own licensing rules and issue a licensing authority policy statement in the first half of 2011.** This reflects our strong commitment to ensuring that the first licences are granted in 2011.

3.16. **In 2010, we will take the necessary steps to prepare the LSB for the possibility of direct licensing.** Section 17 of the Act requires financial and organisational separation between our activities as a licensing authority, and our other activities. We will also need to recommend to the Lord Chancellor a body which will hear any appeals regarding future decisions made by licensing authorities including the LSB.

3.17. There will be important implications for the LSB's staffing and finances. Licensing authorities must require licensed bodies to pay periodic fees, so this aspect of the LSB's operations might be self-financing. We will need to assess in due course the likelihood that we will be directly licensing ABS, and the best way to prepare ourselves for that possibility. We will consult further with stakeholders next year about our approach to direct licensing and the organisational and financial implications, but we would welcome any preliminary views.

Question 1 - What are your views on whether the LSB's objective of a mid-2011 start date for ABS licensing is both desirable and achievable?

Question 2 - How do we ensure momentum is maintained across the sector towards opening the market?

Question 3 – What are your views on whether the LSB should be prepared to license ABS directly in 2011 if necessary to ensure that consumers have access to new ways of delivering legal services?

Question 4 - How should the LSB comply with the requirement for appropriate organisational and financial separation of its licensing activities from its other activities?

4. The benefits of opening the market

4.1. The LSB's commitment to timely development of the ABS regime is consistent with, and indeed shaped by, the statutory objectives which it has a duty to promote. In particular, a liberalised market can improve access to justice; protect and promote the interests of consumers; promote competition; and encourage an independent, strong, diverse and effective legal profession.

4.2. Far from threatening standards, a more liberalised market can, with the right regulatory framework and practice, give all providers the incentives to improve them. In short, it has the potential to deliver substantial benefits to consumers, to individual lawyers, to legal firms and to those who work for them.

Market Changes

4.3. At this early stage in the journey towards ABS, it would be helpful to get views about how opening the market might change both the way that legal services are delivered to consumers, and the structure of the market itself.

4.4. Various consumer groups, market players, academics[7] and consultants have predicted changes such as the emergence of "one-stop shop" MDPs in the high-street; franchising models combining national brands with local management; increased international outsourcing; and online and/or telephone delivery of commoditised basic advisory services by big name retailers. Many of these trends are already observable but new managers, owners and financiers might be expected to more fully exploit them.

4.5. Input from stakeholders about possible trends will help the LSB in working with the approved regulators in the months ahead to do what we can to facilitate potentially positive changes in the market, and manage any associated risks. We summarise below developments in the market for retail opticians' services, as there are some potential analogies with the legal services market and its regulation.

[7] See for example, *The End of Lawyers*, Richard Susskind (2008)

Learning from another sector? – Retail Opticians' Services

In the mid-1980s many of the restrictions on the advertising and supply of spectacles were removed, and changes in the NHS arrangements allowed market forces to improve the range of products available to the public. These developments helped to open up the market and encourage new entrants.

The optical market was broadened beyond the limited range of spectacle frames and lenses provided under NHS arrangements, which had remained virtually unchanged since 1948. In its place the Government introduced a scheme allowing eligible people an NHS voucher which could be used towards any spectacles of their choice. This change encouraged the development of improved designs of both frames and lenses. In 1989 it became a requirement that following a sight test the patient should be handed a written copy of any prescription found necessary following a sight test. This allowed freedom to have spectacles dispensed elsewhere. The dispensing function was deregulated, allowing unqualified and unregistered sellers to supply spectacles, other than to certain protected groups and subject to the production of a valid prescription not more than two years old.

A 2004 Government-commissioned paper[8] on the benefits of competition found the market for optical services had changed substantially. Advertising has grown significantly and the consumer has a much broader choice of products and services. However, the paper found the evidence regarding price was inconclusive. A small number of large national retail players now cover 70% of the market, though there is still a substantial number of independent opticians, some of whom offer niche or specialised services.

The distinctive joint venture business model of Specsavers is worth noting. Each optician's practice is an independent business owned jointly by Specsavers and the practitioners, usually both dispensing and ophthalmic opticians. Specsavers offer economies of scale in product purchasing, training, support services and marketing, but the practitioners are responsible for delivering eye care services and the day-to-day running of the business and are responsible for meeting regulatory standards. This model therefore combines the commercial incentives for strength of the firm with incentives to maintain and enhance professional standards. It offers a smoother service to the consumer, while ensuring proper control of the contribution of individual professionals.

[8] *The Benefits from Competition: some illustrative UK cases*, DTI Economics Paper No.9 (2004)

Vision Express has also been operating some practices on a similar basis since 1995, while Boots Opticians, Dollond & Aitchison and a number of other groups have some franchised practices.

The General Optical Council ("GOC") regulates individual optometrists (who conduct eye tests), dispensing opticians (who advise on spectacles and contact lenses) and optical businesses. There is a separate GOC Code of Conduct for optical businesses, in addition to a Code for individual practitioners. The GOC's work is overseen by the Council for Healthcare Regulatory Excellence.

Consumers

4.6. The legal services market-place should be driven by the needs and preferences of consumers today and less defined by the way in which professionals have traditionally chosen to offer their services in the past. The potential benefits to consumers from a liberalised legal services market-place include better value, improved information, increased choice, greater innovation, more flexible service delivery and new service combinations.

4.7. A central component of this is greater use of the opportunities offered by new technology. Experience of the Legal Services Commission ("LSC") funded Community Legal Service suggests considerable consumer demand for telephone and web-based advice and information, even in areas which have been previously thought to depend exclusively on face-to-face contact. In the last five years there has been a significant shift, with the majority of legal aid services now being provided over the telephone, even where advice is still available face-to-face. This replicates the experience of NHS Direct in the health sector and the scope for such innovation is likely to increase over time.

4.8. We have spoken to consumer representative organisations including Citizens Advice and Consumer Focus, which foresee benefits from opening the market. A key success measure will be increased access to legal services for retail consumers on modest and middle incomes. However, the "consumer" is a broad concept in the context of the legal services market place, covering a range of possibilities from a legal aid funded client using a self-employed barrister to defend them in a

criminal law case, to a GC100[9] member commissioning a Magic Circle firm to help execute an acquisition. Small and medium size businesses are also important users of legal services – and by way of example, the potential benefits of ABS to small businesses in the printing industry are summarised below. We would welcome further input from bodies which represent the full range of client interests, including consumer groups, trade associations and in-house lawyers working for large companies and public sector organisations.

Case study: Small printing businesses and legal services

The British Printing Industries Federation ("BPIF") is the largest representative organisation in the printing industry. 75% of its members have less than 20 employees and most of these firms do not have in-house counsel. They are reluctant to approach legal advisers, which the BPIF has found often lack knowledge of their particular sector and use opaque charging structures. As a result, legal disputes arise that otherwise could be avoided and some disputes drag on longer than otherwise needed if a more bespoke service were offered in the first place.

The BPIF says its members are most comfortable contacting legal advisers from within their own trade association, so it would like to offer a specialist legal service. However, since current SRA rules prevent employed lawyers from charging for their services, the resources to do so are severely limited. So the BPIF is interested in setting up an ABS to provide legal services to its members and others in the printing industry.

Legal firms and practices

4.9. The impact of opening the market to ABS upon existing legal firms and practices has been hotly debated. The lifting of restrictions on management structure, and the availability of additional financing options, should offer opportunities for more efficient and better managed firms to grow and prosper. For example, a solicitor's practice in a small town might establish a joint practice with the local accountant or financial adviser, yielding savings on overheads and offering new services to clients. There is also obvious scope for ABS bringing together licensed conveyancers and others in the property sector.

[9] The Association for the General Counsel and Company Secretaries of FTSE 100 companies.

4.10. However, there are some concerns among sole practitioners, self-employed barristers and small solicitor practices that they may struggle to survive in a more competitive environment. As discussed further below, the LSB is alert to any risk to our statutory responsibility to enhance access to justice. However, it is not clear that new entrants represent a real threat to efficient businesses or to consumers. It is arguable that the scope to innovate is potentially as great for smaller practices as for larger firms.

4.11. Experience in the general insurance market suggests that commoditisation of many services can lead to “up-skilling” which has helped to preserve smaller firms in the long run. As more insurance companies began to sell basic products such as motor insurance direct to consumers, insurance brokers responded by specialisation for harder to reach markets and providing more accessible search tools to aid consumer choice.

4.12. The demise of the high-street firm is not therefore an inevitable outcome of opening the market. But it may accelerate the need to adapt to changing consumer needs, enhanced competition, specialisation and changing technology. In this, law is no different to any other market and trends such as consolidation and specialisation are already observable. So the focus of regulation should be on the statutory objectives, rather than being designed to protect a particular organisational model. We are very keen to hear from regional law firms, smaller practices, sole practitioners and barristers about how they see the sector evolving as the market opens up.

4.13. At the other end of the market, some Magic Circle firms have questioned whether ABS is relevant to them because they operate across a number of jurisdictions where ABS models would not be permitted, and they may have less need for external capital. There is also some scepticism about whether corporate legal work will prove as attractive to new investors as parts of the market which can be “commoditised”. The Australian experience suggests the largest firms may maintain their partnership structure – most firms which have adopted alternative structures are small or medium-sized.

4.14. However, others speculate[10] that UK firms which take pragmatic decisions about their corporate structures could gain in terms of international competitiveness, given the fragmented nature of regulation in other jurisdictions. There may also be synergies between the development of an ABS licensing regime and changes to the regulation of corporate law firms that better reflects their risks, size and customer base (this is discussed further below). We would welcome input from Magic Circle and City law firms on this.

Lawyers and non-lawyer employees

4.15. Individual lawyers and other employees of legal firms could also benefit from ABS. There will be some lawyers who are attracted to evolving their businesses and innovating, and the new climate could offer great opportunities and potential rewards. But for others, for example those who do not want to have to take on significant managerial responsibilities as their career progresses, development of ABS offers the opportunity to carry on focusing on what they do best – the practice of law on behalf of their clients – confident that their firms or Chambers can recruit and retain those with strong management skills. It also enables lawyers from a variety of different professional backgrounds to band together in businesses to specialise in individual aspects of law, offering a more seamless service to the customer (and to non-specialist firms who choose to refer onwards).

4.16. Non-lawyer managers – who may have skills in core functions such as strategic leadership, human resources, finance, IT and marketing, which can be critical to the overall success of their firm – will benefit from the new right to join the partnership of a LDP, and later ABS. For example, a legal executive advocate recently became the first legal executive to be made a partner in a law firm under the new regulatory arrangements[11]. And a City solicitors' firm[12] has made its Chief Executive a partner and is adding a patent attorney to its partnership as well.

4.17. Even where the partnership opportunity is not taken, increased competition generated by new entrants should have a beneficial effect

[10] See for example, *External investors in law firms – Opportunity or threat?* Allen & Overy seminar summary (2008).
[11] *Firm appoints first legal executive partner in LDP move*, The Law Gazette (8 April 2009).
[12] *Olswang to make patent attorney partner in LDP move*, The Law Gazette (16 April 2009).

on enhancing back office functions, strategic planning and marketing within firms, so helping firms refine and improve their offering. In turn, this could then help to make the firm more attractive to providers of external finance, at best creating a virtuous circle of continuous improvement underpinning sustained commercial expansion.

Diversity

4.18. The Panel on Fair Access to the Professions is currently looking at the processes and structures that govern recruitment and progression into the professions (including law), in order to improve access to all people, regardless of background. A greater diversity of management and organisational models might have a positive impact upon the diversity of the profession. Some have told us that some younger lawyers are attracted to stable employment structures and more conventional working hours, rather than committing everything to the prospect of partnership. A less rigid management structure could make it easier for younger lawyers to have an influence within an ABS, be it as a manager or not.

4.19. We also need to be aware that currently a high proportion of solicitors from BME communities are sole practitioners or work in small practices, with much lower representation in larger firms or Chambers. Changes in market structure might impact upon the diversity of the profession as a whole and/or rates of progression within it. The LSB and the approved regulators will therefore need to monitor the equality and diversity implications of ABS.

4.20. If significant changes lie ahead in the way in which lawyers work, and the skills required to meet the needs of clients, this will have implications for the education and training of lawyers, starting at law schools. Our initial thinking, however, is that it would not be appropriate to impose any mandatory training requirements for ABS, other than those which are required of individual practitioners at present or which may be demanded in the context of wider entity-based regulation in the future. This is an area which the LSB plans to explore further. But in the meantime we would welcome input from individual lawyers, their representative arms, and law schools, about the educational and development opportunities and challenges associated with ABS and

who should take what action to help ensure that they are properly addressed.

Recession

4.21. Finally, we would welcome views about whether the current economic downturn adds further weight to the case for getting the ABS regime in place. The small number of early applications for LDPs has been partly attributed to a lack of incentive to change the structure of a partnership at a time of commercial pressure. This may be the case, but we suggest the current climate provides a reason for impetus in liberalising the market. Better management, greater flexibility in accessing capital, and more scope to offer combinations of legal and non-legal services, could enhance the capacity of firms to adapt and survive sharp fluctuations in demand for some types of legal work (e.g. conveyancing).

4.22. **To summarise, the LSB foresees major benefits from the development of the ABS regime, which is why we are giving such high priority to this issue. But to get the regulatory regime right, it is helpful to have a rounded picture of the opportunities that ABS offers.**

Question 5 - How do you expect the legal services market to respond and change as a result of opening the market to ABS?

Question 6 - In what ways might consumers of all types – including private individuals, small businesses and large companies – benefit from new providers and ways of delivering legal services?

Question 7 - What opportunities and challenges might arise for law firms, individual lawyers, in-house lawyers and non-lawyer employees of law firms as a result of ABS?

Question 8 - What impact do you think ABS could have on the diversity of the legal profession?

Question 9 - What are the educational and developmental implications of ABS and what actions need to be taken to address them?

Question 10 - Could fewer restrictions on the management, ownership and financing of legal firms change the impact upon the legal services sector of future economic downturns?

5. Managing the risks of opening the market

5.1. Whenever opening the market to ABS has been discussed in recent years, a number of potential risks have been raised. The role of regulators is to understand, reduce and manage risk in a way that minimises barriers to entry but provides sufficient protection for consumers.

5.2. But risk is far from unique to ABS – many of the risks identified can be found in relation to existing legal practices and firms. As discussed further below, approved regulators, notably the SRA, have started to move towards risk-based regulation of entities rather than focusing on the conduct of individual lawyers.

5.3. The LSB wants to ensure that any additional requirements placed on ABS (both individually and as a class) by licensing authorities are proportionate and do not unfairly alter the balance of competition. Our starting point is that, in the absence of a compelling case for further restriction, the differences between the ABS regime and that which bites on all sector participants should be minimal in number, evidence-based and restricted only to those set out in the Act.

5.4. In order to develop a robust regulatory regime, more clarity and consensus is needed regarding the nature and scale of any risks, and whether particular types of business structure (e.g. specific service combinations offered by MDPs) are so intrinsically higher-risk than others as to merit additional regulatory controls. We summarise below some of the risks to the regulatory objectives which have been identified, including during the passage of the legislation[13] and in discussions at the College of Law's Forum.

Improving access to justice

5.5. As discussed above, the opening of the market for legal services to new business structures, could lead to greater competition and innovation in service delivery. Some hypothesised changes in delivery models, such as the increased online availability of affordable and commoditised basic legal guidance or advice, could enhance the accessibility of legal

[13] See for example, *Joint Committee on the draft Legal Services Bill – First Report*, House of Lords and House of Commons (2006).

services to consumers. However, some fear that an increasingly competitive market, potentially including large retail brands, could make it harder for some groups of consumers to secure access to justice. They have predicted changes in market structure (e.g. closure of small practices in rural areas made economically inefficient as a result of new entry) which could reduce the accessibility of face-to-face legal advice for people living in more remote areas. Similar suggestions have been made about changes in market structure arising from changes in the legal aid rules in recent years, although it is not clear this is being borne out in practice. This issue is considered further below.

Protecting and promoting the interests of consumers

5.6. Most individual consumers use legal services on an irregular basis and so may struggle to judge quality or learn from repeat purchases. This suggests an ongoing need for sector-specific regulation to protect their interests and a system of rapid informal redress. But licensing authorities will need to consider whether clients of ABS are at an increased level of risk. For example, one issue to address will be ensuring that client money is protected in the event of an ABS being closed down. We would welcome views on whether and why ABS presents an increased risk of loss of client money, and whether particular complexities might arise from the collapse of MDPs. This issue is addressed in the Act and is considered further below.

Encouraging an independent, strong, diverse and effective legal profession

5.7. Some barristers[14] have voiced concern that allowing barristers to establish partnerships with other lawyers and/or non-lawyers might damage the high-standing of the Bar which they say is closely linked to self-employment as the main form of organisation. They also state that LDPs and ABS might eventually undermine the "cab-rank rule"[15], particularly in niche areas of the law, if too many barristers become employed and are therefore potentially precluded from some client work because of actual or perceived conflicts of interest, thus arguably threatening access to justice and the reputation of the profession as a

[14] See *Legal Disciplinary Practices and Partnerships of Barristers - Second consultation paper*, Bar Standards Board (2008).
[15] The cab-rank rule requires self-employed barristers to accept work they have the time to undertake, which is within their expertise, and for which an appropriate fee is offered, irrespective of the strength of the client's case or their view of the character, beliefs or behaviour of the client.

whole. Publicly-funded work might also suffer from a greater separation from commercial work which could offer better opportunities to barristers. It has also been argued that access to justice, consumer choice and the business models of self-employed barristers may be threatened by greater integration within legal practices, which seek to keep advocacy services "in house" for commercial motives, whether through solicitor advocates or employed barristers.

5.8. Another concern that has been raised is the payment of referral fees by advocates to attract business from referring solicitors also poses risks. On the one hand, there is an attraction to the client in being able to receive a seamless "end-to-end" service. On the other, it would be wrong to act to undermine the duty of the referring solicitor to act in the best duty of their client or to leave the client unaware of their ability to access different forms of advocacy. The LSB would also be interested to receive evidence of risks to the regulatory objectives in this area and any mitigating policy proposals, perhaps focused around greater transparency of arrangements and options to clients, in this area, which will be considered both in the LDP/ABS context, and in relation to the wider scrutiny of referral fee arrangements, which our Business Plan signals we will ask the Consumer Panel to undertake.

5.9. We welcome views about how a strong career structure for those who wish to specialise in advocacy can be maintained, and how the accessibility of specialist advocacy can be maintained in a market open to ABS.

5.10. Meanwhile, if a number of new market entrants were to collapse, there is a potential risk of a loss of confidence in the sector as a whole. However, regulators do not usually seek to run a "zero failure" regime and there are long-standing arrangements run by the SRA to protect client interests in the event of a failure of an individual solicitor's firm, which are regularly invoked without detriment to the reputation of the profession. The challenge therefore is to ensure that the nature of the regulatory regime does not add materially to the risk of failure (while not protecting inefficient providers) and that robust arrangements are in place, both managerially and commercially, to protect clients' interests on the rare occasions when it happens.

Promoting and maintaining adherence to the professional principles

5.11. We will seek a regime where lawyers working in all types of business structure adhere to the professional principles, including acting in the best interests of their clients. In addition to that referred to in 5.6, various potential conflicts of interest in relation to ABS have been suggested including:

- Lawyers within the same firm acting for clients on different sides of a dispute/case
- Lawyers within MDPs coming under undue pressure to cross-sell non-legal services
- Lawyers coming under undue pressure to share information provided by the client under legal professional privilege with other parts of the business resulting in the loss of privilege
- Lawyers under undue pressure from non-lawyers with a material interest in the firm
- The conflict between the duties to shareholders and clients within a company (and particularly a publicly floated company) providing legal services

5.12. There may be some types of business model that are regarded as particularly high-risk. For example, it has been said that a MDP bringing together insurers and lawyers might create potential conflicts in the field of personal injury. We are seeking specific examples of ABS that give rise to particular concern and suggestions for mitigating measures which will require regulatory focus.

5.13. Of course, approved regulators already have rules in place to manage conflicts of interest within legal practices, and we should not assume that the risks in relation to ABS are substantially different from those already found within legal practices.

5.14. We can also learn some lessons from the regulation of “ABS-type firms“ in the market today. For many years, Council for Licensed Conveyancers (“CLC”) rules have allowed non-lawyers to sit on the board of conveyancing firms, provided they were not in a majority. These rules have recently been relaxed, and now only a single licensed conveyancer is required. In addition, external investment is already permitted within recognised bodies offering conveyancing services. We

would welcome any views from stakeholders about whether any particular new risks to consumers have arisen from conveyancing firms with this type of management structure and/or external investment and whether the CLC has been short of regulatory tools to deal with them.

5.15. Trade mark attorneys and patent attorneys have also been able to act within mixed partnerships and mixed bodies corporate for some time. Those mixed partnerships have allowed some non-qualified partners/directors to own and manage such structures (only 25% of the partners/directors must be "qualified persons"). Once again, we welcome input from stakeholders with experience of this part of the profession on the management of any risks to consumers.

5.16. In considering how to regulate conflicts of interest, the LSB and regulators can also learn lessons from Australia, where an ABS-type regime has been established for some years and a regulatory framework has been developed to manage conflicts of interest (see box).

Learning from ABS in Australia

In New South Wales[16] legal services firms can incorporate and provide legal services to clients either alone, or alongside other service providers. There must be at least one legal practitioner director within an Incorporated Legal Practice ("ILP") and they are responsible for ensuring that "appropriate management systems" are implemented and maintained by the ILP, so that legal services are provided in accordance with legal professional obligations.

Australia also has experience of the floatation on its stock market of law firms – Slater & Gordon was the first to be listed in May 2007 and Integrated Legal Holdings Limited (a holding company of law firms) followed in August of the same year. A number of safeguards were put in place by the regulator including a clear statement in the listing entity's prospectus that should an inconsistency or conflict arise between the duties of the company and the duties of the lawyers employed by the company, the company's duty to the court will prevail over all other duties and the company's duty to its clients will prevail over the duty to the shareholders.

[16] See Office of the Legal Services Commissioner website at: http://www.lawlink.nsw.gov.au/lawlink/olsc/ll_olsc.nsf/pages/OLSC_index

5.17. Adopting a similar approach to the hierarchy of duties would be consistent with the statutory objectives. So we will consider whether the provisions of the Act in relation to regulatory conflict enable the LSB to make this approach, given that company law is clear in the obligations it places on directors. We would welcome views on both the desirability and practicability of such a statement, setting out a hierarchy of duties.

5.18. **Managing conflicts of interest will be a key issue as the licensing framework develops. So we would welcome input from all stakeholders about the key conflicts of interest and other risks to our regulatory objectives in relation to ABS, including any risks not identified above. We would also welcome suggestions to mitigate those risks.**

Question 11 - What are the key risks to the regulatory objectives associated with opening the market to ABS and how are they best mitigated?

Question 12 - Are there particular types of business structure or model which you consider to present a particular risk to the regulatory objectives?

Question 13 - What conflicts of interest do you think might arise in relation to ABSs and how should they be managed?

6. Risk-based regulation of entities

6.1. The Act introduces a licensing regime for ABS. This is a key part of a broader and important transformation in the way in which legal services will be regulated.

6.2. The traditional approach to the protection of clients has been to focus on regulating the conduct of individual lawyers, rather than on the risks associated with a legal practice or the firm as a whole. Authorised lawyers sign up to the minimum standards defined by their professional regulatory body. For example, the Solicitors' Code of Conduct sets out core duties for all practicing solicitors, including upholding the rule of law and acting in the best interests of each client. A largely reactive approach has been taken to the enforcement of these rules, driven by complaints of alleged misconduct by individual lawyers sometimes leading to disciplinary action.

6.3. Meanwhile, previous legislation and self-regulatory rules erected absolute barriers to entry for certain business structures and models, such as non-lawyer ownership of legal practices. These restrictions were often perceived as a form of consumer protection, because they restricted (potentially) higher-risk business structures/models from entering the market, but they were disproportionate and anti-competitive in impact. **The introduction of licensing for ABS not only removes these absolute entry barriers, but also shifts the focus of regulation from individual lawyers to the organisational entity providing legal services.**

6.4. The SRA has already taken a significant step in this direction although some observers suggest it has further to go (see below). Recent changes to the Solicitors' Code have introduced firm-based regulation, in the form of new rules for LDPs. Individual solicitors are still expected to abide by relevant rules, including the core duties, and disciplinary action will be taken where appropriate. But the SRA is moving towards a regulatory and compliance framework which places greater emphasis upon managing the risks to the client associated with a firm as a whole, rather than focusing exclusively on individual lawyers within that firm.

6.5. Meanwhile, the CLC has an established system of regulation for recognised bodies, and has stated that it plans to move away from a

programme of routine inspections for all firms, to a system of risk based checks to ensure that high-risk firms meet the required standards.

Best regulatory practice

6.6. The approved regulators – and the LSB – are under a duty to have regard to the Better Regulation principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases where action is needed. They will need to be mindful of best regulatory practice in developing their approach to regulating ABS.

6.7. The recommendations in the recently published Smedley Review of the Regulation of Corporate Legal Work[17] are of some relevance. The Review proposed changes to the regulatory system to better tailor it to the particular risks of corporate law firms providing services to corporate clients. It called for a less reactive approach, and stronger ongoing engagement between the regulator and the regulated. The focus of monitoring and enforcement should be on strategic, system level issues such as audit, risk management and governance. The report added that significant organisational change was needed at the SRA to deliver this new approach to regulation.

6.8. We do not comment here on the specific recommendations in the Smedley report. However, we suggest there are some common themes and synergies between possible changes to the future regulation of corporate legal work and the future regulation of ABS. In developing their licensing rules, including the ongoing approach to supervising ABS, regulators will need to take a view about the risks associated with these firms and the appropriate tools and organisational structures for regulating larger businesses.

6.9. This may have a significant impact upon the operational model of the regulator and its staffing. It does not imply a wholesale shift away from a focus on regulation of professional conduct. As discussed below, the HoLP and the HoFA within an ABS will have key responsibilities and will be held to account by licencing authorities for their discharge of them. But it does imply a focus on broader issues of governance and risk

[17] *Review of the Regulation of Corporate Legal Work*, Nick Smedley (2009).

management within the entity, rather than on compliance with professional ethical codes by individuals alone.

6.10. We suggest that potential licensing authorities should develop a risk-based approach to regulating the ABS they license, building on the framework which the Act sets out for lighter regulation of special bodies (see Chapter 8). This will be informed by an initial assessment of the particular risks associated with the firm at the point of licensing. It is likely to require a different regulatory skill set from the traditional approach to regulating individual lawyers, in particular a greater understanding of corporate structures and how businesses are run. It may also require investment in new technology by the regulators to ensure they are collecting, maintaining and drawing the right conclusions from various information sources about the firms they regulate.

6.11. **We welcome views about how risk-based regulation of ABS should work in practice and how it fits with the broader ongoing role of approved regulators in regulating legal practices and individual lawyers.**

Outcomes-based regulation

6.12. Another key strategic decision for any regulator is whether it sets out high-level principles and outcomes it wants to achieve, or adopts a more prescriptive approach to rule-making. In recent years, some regulators – most notably the Financial Services Authority ("FSA") – have moved towards the former, with greater emphasis upon the over-riding duties on firms, such as treating their customers fairly. The advantage of this is that it focuses minds on outcomes and objectives, rather than attempting to write detailed rules on processes. It also gives greater flexibility to firms on how they meet the principles and outcomes, and it can leave more room for innovation and competition.

6.13. The core duties on solicitors in the Solicitors' Code could be viewed as high-level principles in that they form a framework for the rest of the rules. The SRA and others might usefully consider how they could be adapted to the firm level for ABS. However, some firms consider that a more prescriptive approach to regulation gives them greater certainty and less regulatory risk. And some commentators have questioned the

FSA's shift towards principles-based regulation in light of the recent crisis in financial markets, given that it has become clear that a number of very large firms were not in compliance with some of the FSA's Principles for Business. However, systemic risks are important to a much greater extent in the financial services sector than is the case in legal services, so we need to be wary of interpreting recent events as a reason to revert to a prescriptive approach to rule-making.

6.14. We expect that our guidance to licensing authorities on the content of licensing rules will be high-level, although, of course, a prospective licensing authority might propose that it should take a more prescriptive approach. One approach could be to offer more detailed guidance on optional "safe harbour" ways to comply with the high-level rules for those firms that seek greater regulatory certainty. This would leave flexibility for other firms to adopt different practices which they can show are consistent with the high-level rules.

6.15. We are attracted to the outcomes-focused approach of the Office of the Legal Services Commissioner ("OLSC") in New South Wales, which requires ILPs to evidence compliance with 10 objectives of sound legal practices. These objectives include competent working practices to avoid negligence and effective, timely and courteous communication. The OLSC has developed an "education towards compliance" strategy and online packages and systems to facilitate self-assessment processes. This puts the onus on legal practice directors in ILPs to show that ethical conduct has been systematically defined and implemented within their firms. There is some emerging evidence[18] that ILPs that have gone through this process have lower complaint levels than conventional law firms that have not incorporated.

6.16. We are also interested in the Bar Standards Board's (BSB) current programme of work to develop effective quality assurance measures for barristers, which could offer useful learning points when developing regulatory standards for ABS.

6.17. **It would be useful to have input from regulators, firms and consumer groups about the appropriateness of an outcomes-**

[18] *Research reports: assessing the impact of management-based regulation on NSW incorporated legal practices*, Christine Parker, Steven Mark and Tahlia Gordon (2008).

focused approach to regulating ABS, given the requirements to have regard to the principles of better regulation in the Act.

Entry requirements

6.18. A licensing system of regulation still provides scope for regulators to prevent some applicants from entering the market. The licensing authority will only grant licences to applicants that comply with its licensing rules. Section 83 and Schedule 11 of the Act set out various provisions that must be included within the licensing rules.

6.19. For example, a licensed body (there are exceptions for special bodies which are covered elsewhere) must have a HoLP and a HoFA. The Act does not specify that they have to be different people but this is likely to be appropriate given they are distinctive roles. Licensing authorities may wish to make this clear in their licensing rules. The HoLP – who must take all reasonable steps to ensure compliance with the terms of the licence – and the HoFA – who must take all reasonable steps to ensure compliance with the rules relating to client money – will have key roles in ensuring the firm does not act in a way which is contrary to the interests of consumers. A licensing authority will only be able to approve a person's designation as a HoLP or a HoFA if they are satisfied they are a "fit and proper person" to carry out those duties.

6.20. The Act also states that at least one of the licensed body's managers must be an authorised person in relation to a licensed activity. But it adds that a licensing authority may include further provisions in their rules regarding managers of licensed bodies, provided that it does not require all managers to be lawyers. So a licensing authority could propose to introduce further entry requirements, such as tests of the suitability/competence of the managers, or requiring that a majority of managers should be lawyers.

6.21. The LSB will issue draft guidance on the content of licensing rules for consultation later in the year. **At this stage, we are of the view that regulators should be cautious about proposing new entry requirements, in addition to those set out in the Act.** Any proposals should be backed by evidence of the risk proposed and the consumer detriment that might arise.

6.22. For instance, we are sceptical that a requirement on all ABS to have a majority of lawyer managers and/or owners would be in the best interests of consumers, and suggest there are alternative less restrictive ways to manage any additional risks associated with a minority-lawyer management/ownership structure. We note that the regulatory regime in New South Wales only requires there to be one legal practitioner director in an ILP.

Fit and proper test

6.23. Last year the SRA consulted on the character and suitability test it would apply for non-lawyer managers of an LDP. It concluded[19] that a non-lawyer manager should be subject to the same general principles on the assessment of character and suitability as those applying to individuals wishing to become solicitors.

6.24. The test focuses on issues such as past criminal convictions and allegations of previous misconduct in business activities. The Government amended the Rehabilitation of Offenders Act to extend the enhanced Criminal Records Bureau checks that apply to new solicitors to non-lawyer managers of LDPs. This reflects the sensitive nature of legal work and the extra care that is needed in relation to who handles this information.

6.25. However, minimal additional information is requested of non-lawyers managers in a LDP relative to lawyer managers in assessing if they are "fit and proper". There is no specific training and competence requirement, because no such requirement applies to lawyer managers[20] and it is assumed that the firm will have satisfied itself that the manager has the requisite skills for the role.

6.26. Our initial view is that licensing authorities should be similarly cautious about introducing more stringent requirements on non-lawyer managers of ABS, not least because we do not consider it either feasible or appropriate for regulators to define robust and enforceable criteria to assess the suitability of an individual for a general management responsibility.

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[19] *Character and suitability test for non-lawyer managers of an LDP*, Solicitors Regulation Authority (2008).

[20] Although training in "ethics" is a core part of the Legal Practice Course and all practising lawyers have to be familiar with their respective codes of conduct.

6.27. However, we do plan to review the criteria and approaches used by other regulators that operate “fit and proper” tests. For example, the FSA’s fit and proper test for candidates carrying out controlled functions and other approved persons focuses on the following factors: honesty, integrity and reputation; competence and capability and financial soundness. Moreover, the test used by the Gambling Commission in assessing applicants for a gaming operating licence (and where the operator is a corporate body – the body itself, its directors, partners or officers, and those who own a 10% interest in that body) focuses on five basic areas: identity; criminality; finances; integrity and competence. In addition, some key managers in the operator are separately licensable as individuals and are subject a fit and proper test.

6.28. One matter that may arise is whether non-lawyers with professional qualifications, who have been through fit and proper tests laid down by their own professional bodies or another regulator, should be subject to an additional test by the licensing authority if the test they have passed is of a similar or greater standard than the respective tests for lawyers. Precedents for not requiring this include the SRA’s regime for recognising registered foreign lawyers and the “passporting” of individuals under the FSA’s regime for assessing fitness and propriety.

Regulation of licensed firms

6.29. In considering the case for additional entry requirements on licensable bodies, it is important to appreciate that the licensing rules will address not only the handling of licensing applications, but also the licensing authority’s ongoing approach to regulation of ABS. The regulation of ABS firms will not be limited to a single entry point decision as to whether the firm should be granted a licence. **It is this ongoing conduct regulation of the ABS – the entity – by the licensing authority which will be critical in ensuring that consumers gain benefits from ABS rather than suffering detriment.**

6.30. So, in developing their licensing rules, a key consideration for regulators will be the appropriate balance between protecting consumers by rejecting licence applications, imposing additional conditions and/or using their ongoing regulatory powers to ensure higher-risk new market entrants are in compliance. The potential advantage of the compliance-

led approach is that it allows consumers to have the choice of services offered by the new entrants, and avoids regulators seeking to second guess markets and the quality of management to a potentially unrealistic extent. However, it relies on approved regulators having the capacity to effectively monitor ABS without seeking to manage them. It may also involve some increased risk of firms failing and/or of consumer detriment, at least in the short-term.

6.31. We expect senior management of an ABS to have a collective responsibility for ensuring compliance with the licensing rules and in managing conflicts of interest, rather than relying exclusively on the HoLP and HoFA. So regulators will need to be clear about which requirements bite on an entity as a whole and which on the HoLP and HoFA personally or jointly.

6.32. For example, a regulator may wish to grant a licence to a "higher-risk" firm, but, in so doing, categorise it as a firm which requires a more intensive relationship, including periodic visits. The objectives of these visits might be to satisfy the regulator that the right corporate culture and governance arrangements are in place to manage any conflicts of interest and avoid undue pressure being placed on lawyers to compromise their professional principles. Such visits might involve random inspection in some cases, in order to assess the robustness of systems in practice, rather than an abstract scrutiny of the arrangements on paper. We note that the initial paper issued by the Hunt Review[21] argued that the SRA should take a greater interest in the robustness of the internal governance arrangements of firms, and added this would be particularly important when it came to regulating ABS.

6.33. In developing their licensing rules, both on market entry and ongoing risk-based compliance, regulators will need to be alert as to whether they are establishing a "level regulatory playing-field" between licensed ABS and regulated legal practices and individual practitioners. Differential approaches *may* be desirable, but only if they reflect an underlying distinction based on evidence about the risks associated with the different types of firm, and regulators should be clear that is indeed the case. Indeed, some ABS may be lower-risk than some legal practices, so we expect regulators to avoid blanket assumptions about

[21] *Hunt Review – Initial Response to Evidence*, Rt Hon Lord Hunt of Wirral MBE (2009).

relative risk levels. When seeking to become licensing authorities, regulators should be clear about how they will assess risk at the point of application and how they will take a risk-based approach to monitoring compliance going forward.

Question 14 - How should licensing authorities approach entity-based regulation and what are the main differences from the traditional focus on regulating individuals?

Question 15 - Do you agree with our view that licensing authorities should take a risk-based approach to regulation of ABS, and if so, how might this work in practice?

Question 16 - What is your preferred balance in regulating ABS between a focus on high-level principles and outcomes and a more prescriptive approach?

Question 17 - What are the advantages and disadvantages of a requirement on ABS to have a majority of lawyer managers?

Question 18 - What are your views about how licensing authorities should determine whether a person is a “fit and proper person” to carry out their duties as a HoLP or a HoFA?

Question 19 - What is the right balance between rejecting “higher-risk” licensing applications and developing systems to monitor compliance by higher-risk licensed bodies?

Question 20 - How should regulators ensure a level playing-field between regulated legal practices and licensed bodies?

7. Specific regulatory issues

7.1. We are seeking initial views about some key regulatory issues to help us develop our draft guidance on licensing rules for consultation later in the year.

Access to justice

7.2. The Act specifically requires a licensing authority's licensing rules to address how it will take account of the access to justice objective in connection with an application for a licence (Section 83 (5)(b)). As noted above, there are different views about whether the opening of the market as a whole to ABS represents a risk to the statutory objective to improve access to justice.

7.3. The LSB considers that the concept of access to justice is broader than the geographical availability of face-to-face legal advice and representation, and ABS may play an important role in opening up new ways of delivering legal services to consumers. So we expect that the access to justice objective will usually be a positive reason for granting a licence rather than a reason for turning an application down.

7.4. For some groups of consumers (e.g. the elderly), easy access to face-to-face legal advice and representation could still be important to their ability to access justice. We would be interested to see any evidence to support this proposition. **We would welcome views, particularly from consumer and not-for-profit bodies, about how we should define and evaluate access to justice.**

7.5. At this stage, we suggest regulators will need to approach this provision with some care. They should be alert to the danger of making assumptions about the impact of a single firm on the future structure of the market, whether at a local, regional or national level.

7.6. It is likely to be difficult to reasonably conclude that an application from a single licensable body – even a very large retail brand for instance – would reduce access to justice for consumers as a whole, whether in a given geographical area or more widely. So we would be concerned if this condition led to unnecessary restrictions on market entry, or undue regulatory burdens, being placed uniquely on ABS which might

otherwise strengthen competition, increase consumer choice and enhance access to legal services. **We think it is unlikely that the access to justice provision alone should lead to the rejection of applications for ABS licences by licensing authorities, but we would welcome views on that proposition.**

7.7. The LSB and approved regulators, along with the Government and the LSC will need to monitor the impact that opening the market to ABS – and other trends such as the expansion of online services – has on access to justice. There may be medium-term implications for related issues such as legal aid funding and commissioning, and the development of community legal services. But we expect that competition will drive innovation in all parts of the market and enhance access to justice.

7.8. We also note the well-established pattern of many large firms and Chambers facilitating solicitors and barristers in doing *pro bono* work. It will be interesting to note whether new market entrants adopt this practice. It could be beneficial, not only in terms of enhancing access to justice, but also in encouraging an organisational culture which promotes adherence to the professional principles.

Indemnification/compensation

7.9. The Act specifies that the licensing rules should include appropriate compensation arrangements and indemnification arrangements for ABS. It adds that to give effect to these arrangements, the licensing rules may:

- authorise or require the licensing authority to establish and maintain a fund or funds;
- authorise or require the licensing authority to take out and maintain insurance with authorised insurers;
- require licensed bodies or licensed bodies of any specific description to take out and maintain insurance with authorised insurers.

7.10. Current SRA rules on indemnification require solicitor firms to obtain a minimum level of professional indemnity insurance (“PII”) in order to cover claims of professional negligence and other forms of civil liability

arising from their work. The rationale is that, if clients experience difficulties in recovering claims, this might undermine public confidence in the profession as whole. So solicitor firms are expected to seek annual PII directly from a qualifying insurer.

7.11. If they cannot obtain cover from the market, they can apply to be admitted to the “Assigned Risks Pool” (“ARP”). This is a higher-premium scheme which is underwritten by all qualifying insurers to provide cover for all eligible firms for up to two years. If a firm continues in practice without indemnity cover, then clients of the firm will continue to be protected through the ARP until the position is regularised by cover being obtained or the SRA taking steps to close the firm down. In addition, the Solicitors Indemnity Fund provides cover for claims against firms which have ceased to practice without successor (after the automatic six-year run-off period provided by all policies of qualifying insurance has expired).

7.12. The BSB takes a different approach. Its rules require self-employed barristers to obtain minimum levels of cover from the Bar Mutual Indemnity Fund (“BMIF”). The BMIF is a mutual set up by barristers to provide cover for barristers, in the event of claims of professional negligence.

7.13. We would welcome input from insurers and law practices about the issues associated with cover and pricing PII for ABS entering the market. It is hard to predict whether insurers will regard different business models as involving different levels of risk and if so how this will affect cover and price. Assessment may turn on views of the track record of individuals and the robustness of individual business plans rather than being driven primarily by the nature of the business or ownership structure.

7.14. Given that the ARP scheme was designed to offer temporary relief for practitioners finding it difficult to access PII, we seek views on how, if at all, the ARP will be relevant to new business models.

7.15. A further issue that merits wider debate is to what extent licensing authorities should seek to pre-empt indemnification arrangements ever being triggered by regulating the capital adequacy of new entrants, either at the point of granting a licence and/or on an ongoing basis. This

would take legal services regulation into wholly uncharted territory and lead to considerable challenges in terms of skills for licensing authorities and, almost certainly, costs for licensed firms. In a competitive market, in which a zero-failure regime should not be an objective, such additional entry controls may not be appropriate. Some of the benefits of ABS might be lost, if regulators were to seek to substitute their views on adequacy for those of market investors. The safeguard for consumers should, in our view, come from protection for individual client monies, not control over the capital structure or adequacy of the entity.

7.16. There is room for debate about the nature of the trigger for intervention by licensing authorities to protect the interests of consumers if a firm faces insolvency. A trigger mechanism might be, for example, failure to meet banking covenants, or withdrawal of a set proportion of capital by a private backer, without adequate replacement. Advocates of such an approach need to address why a separate regime for ABS is needed, as opposed to a requirement on all firms to notify regulators when a defined risk threshold is passed. The regulatory "tool-kit" for responding in such circumstances also needs to be carefully defined, starting from the position that the job of the regulator is to ensure protection for client interest and money, not to preserve the solvency of the firm.

7.17. With regard to compensation beyond PII cover, the SRA operates the Solicitors Compensation Fund which is funded by a levy on all solicitors that hold client funds. This is intended for clients who have suffered losses either because of the dishonesty of solicitors or because of a failure to account for money held.

7.18. Another important aspect of client protection is the arrangements the SRA has in place for circumstances where it closes down a solicitors' firm. It appoints an intervention agent to distribute client money held by the firm. The Code of Conduct also states that solicitors are under an obligation to transfer a file to another lawyer (with the client's consent) if they are aware that insolvency is imminent.

7.19. The key principle for ABS should be that, as for all other legal firms holding client monies, the consumer should receive compensation, as quickly as possible after the collapse of an ABS. Another consideration

is that the clients should be able to get their legal issues brought to a conclusion with minimal disruption.

7.20. **Our starting presumption is that regulators should seek to adapt their existing requirements and arrangements to accommodate the supply of legal services by ABS but there are important issues that require further debate and consideration. We would welcome any initial views about the advantages and disadvantages of the approaches set out in the Act, the fit with the existing compensation and indemnification arrangements for law firms and, if necessary, what modifications are needed to existing arrangements.**

Complaints-handling

7.21. Another issue that regulators and the LSB will need to address is complaints-handling in relation to legal services provided by ABS. Part 6 of the Act establishes an Office for Legal Complaints ("OLC") which will offer an independent ombudsman service for unresolved legal complaints. The jurisdiction of the scheme will, in due course, include complaints from individual consumers regarding legal services offered by licensed bodies.

7.22. Complaints can only be handled by the OLC when the firm's complaints procedures have been exhausted. So the regulators will need to make provisions requiring ABS to have suitable procedures in place. The LSB will consider this further alongside the work on first line complaints-handling by legal practices and individual lawyers outlined in our business plan, but we expect that approved regulators will take a similar approach to ABS. We will also need to make provisions for complaints-handling by any ABS licensed by the LSB should we develop our own licensing rules in our capacity as a licensing authority.

7.23. We would need strong evidence to persuade us that the arrangements for complaints handling specified for ABS should be materially different from those specified by regulators for the non-ABS environment. Arrangements need to be robust enough to take account of complaints made against different professionals who may operate under different regulatory disciplinary regimes, and the experience with LDPs will be useful here. In each case the focus on initial dispute resolution should

be on the rapid resolution of the consumer grievance, not the forensic examination of the complaint in a way likely to lead to more formal processes.

7.24. We expect that new entrants to the market will want to offer a high quality complaints-handling service, and to have well developed systems for monitoring trends in the type of complaints they receive. **This is an issue we will address further in our draft guidance on licensing rules, but we would welcome any preliminary views from stakeholders about complaints-handling and ABS.**

Fit to own

7.25. Schedule 13 of the Act includes significant provisions in relation to the ownership of licensed bodies which will need to be addressed in licensing rules. Those provisions establish a test to ensure that anyone who owns a significant interest in an ABS is "fit to own" that ABS.

7.26. We understand the policy rationale behind the test was two-fold: both to limit outside interference through non-lawyer or lawyer owners who exert pressure on management (including the potential problem of organised criminals exerting pressure) and also, to mitigate the risk that the duties owed to a shareholder by directors might outweigh those owed by a lawyer to his/her client.

7.27. The test is set out so that the holding by a non-authorised person of a restricted interest in a licensed body is subject to approval by the relevant licensing authority. Restricted interests cover two types of interest – material interests and controlled interests.

7.28. To summarise, a "material interest" is broadly defined as at least a 10%[22] direct or indirect holding, or a significant influence, over the management of the firm.

7.29. The percentage share of the holding that is defined as a "controlled interest" will be set by the licensing authority, but that percentage share – the interest - must be greater than that which constitutes a material interest. In addition, there is scope to vary the percentages which define a controlled interest according to the precise nature of the controlled

[22] Although the licensing authority's rules can specify a smaller percentage than 10%.

interest (e.g. different percentages can be allowed for shareholdings and for voting rights).

7.30. The licensing authority must take into account the regulatory objectives when deciding whether to approve such restricted interests and must determine whether the non-lawyer owner is a “fit and proper” person to hold that interest.

7.31. The Act states that the licensing authority should have regard to: a person’s probity and financial position; whether the person is disqualified from a management position within the firm; and the person’s associates. The licensing authority may also specify other matters within their licensing rules.

7.32. Although the “fit to own” test is the same for all holders of a material interest, the information requested by the licensing authority can be varied according to risk. Given the greater extent of ownership inherent in holding a controlled interest, it would seem appropriate that the obligations on holders of a controlled interest should be more onerous than apply to those who hold a material interest.

7.33. The information required, and considerations to be taken into account, when determining who is “fit to own” may be similar to those discussed above in relation to the HoLP and HoFA, but it seems reasonable that financial or management competency should not be factors to be considered when licensing authorities devise approval requirements for whether a person is “fit and proper” to hold an interest in a firm (since such a person is not involved in day-to-day decision making). Given one of the rationales of the test is to prevent organised crime, it is particularly worth noting the approach taken by the Gambling Commission, since they have experience in preventing such risks.

7.34. It is important that the licensing authority avoids disproportionate requirements which add undue cost and delay to normal changes in the ownership of a firm and which limit the potential benefits to consumers and firms from the more flexible ownership structure of ABS.

7.35. The HoLP and the HoFA will have key roles in managing any conflict of interest issues which may arise since they ensure that lawyers maintain adherence to their professional principles even in the face of external

pressure (e.g. from non-lawyer managers). A licensing authority will need to exercise caution in introducing stringent requirements in relation to the “fit to own” test since the policy rationale behind the HoLP and HoFA requirements of mitigating the effects of external pressure on lawyers and the policy rationale behind the “fit to own” test covers similar ground.

7.36. However, the “fit to own” requirements provide an extra layer of statutory protection and may be helpful in reducing the burden of responsibility on the HoLP and HoFA within an ABS.

7.37. It is possible that licensing authorities may choose, in their licensing rules, to require the constitution of an ABS to set out a hierarchy of the various duties owed by directors and employees as discussed on p30. Such an approach (as adopted by the Australian law firm Slater & Gordon, which floated in 2007) also helps to mitigate potential conflicts of interest, in the same way that the “fit to own” test and HoLP/HoFA test do. Given the existence of the statutory requirements as described above, there is a question as to whether such an approach is strictly necessary or proportionate in England and Wales, although it may nevertheless have some confidence-building value.

7.38. Licensing rules will need to consider the “fit to own” test carefully. In some circumstances it can be difficult to identify the ultimate beneficial owners of a firm. We would expect that licensing authorities will also want to make clear that firms should ensure their ownership is readily identifiable if they wish their ABS applications and/or changes in restricted interests to be approved. Some international investment in law firms may raise particular difficulties, bearing in mind that it may be harder to identify ownership and/or assess the validity of evidence cited in support of “fitness to own”..

7.39. In addition, licensing rules would need to address the possibility of initial public offerings. It seems that flotation will bring additional considerations into how the “fit to own” test is to be exercised. The increased public transparency and additional regulation such firms will be subject to will need to be taken into account.

7.40. Clearly, this aspect of the Act is an area that we will need to consult on further, in order to give guidance on what percentages are appropriate,

and to address some of the other issues raised here, but we would very much welcome initial input on those issues.

7.41. **In order to ensure that the broader regulatory framework is proportionate and to frame the forthcoming debate on the licensing rules, we would welcome views on the relative importance of this test in mitigating the risk to the regulatory objective of promoting lawyers' adherence to their professional principles (as opposed to the HoLP/HoFA requirements or a possible "constitutional statement" of how duties owed by directors and employees are to be prioritised).**

Non-reserved legal activities

7.42. A further issue often raised in debate is whether consumers are likely to be confused and/or suffer detriment as a result of reserved (as defined by Section 12) and "non-reserved" activities being provided by the same entity. At one level, it could be argued that this is not a new phenomenon: many existing solicitors' firms provide both forms of service. However, regulation of the title of "solicitor" arguably provides a level of consistent consumer protection in this area. This protection might be lost in an ABS world where non-reserved services may be being provided by individuals who are not subject to regulation (although the Act does ensure that the OLC can consider complaints about such services).

7.43. The LSB has signalled in its Business Plan that it would welcome advice more generally from the Consumer Panel about the current definition of the scope of reserved activities and the definition of the criteria which should be used in assessing proposals to widen that scope once careful studies of individual markets have been made. The issue therefore is a far wider one than for ABS alone. The LSB is not persuaded there is merit in wholesale change to bring new activities within the scope of regulation without such study, purely to address perceived inconsistencies arising in a minority of ABS. To do so would potentially introduce as much market distortion as it would remove.

7.44. We would, however, be interested to receive evidence of risk of consumer detriment which may arise in an ABS model and how it can

best be addressed, perhaps, for example, in the detailed specification of the HoLP and HoFA roles.

Question 21- How should licensing authorities approach the access to justice condition, and do you agree that it is unlikely that many licences should be rejected on the basis of the condition?

Question 22 - How should licensing authorities give effect to indemnification and compensation arrangements for ABS?

Question 23 - How should complaints-handling in relation to legal services provided by ABS be regulated?

Question 24 - How should licensing authorities approach the “fit to own” test and how critical is it in mitigating the risk to the regulatory objective of promoting lawyers’ adherence to their professional principles?

Question 25 - Are there are any particular risks to the regulatory objectives that arise from could arise from ABS offering non-reserved legal services?

8. Special bodies

8.1. Under Section 23 of the Act, not-for-profit bodies, community interest companies and trade unions are entitled to carry out reserved legal activities without authorisation for a “transitional period”. Individual lawyers employed by these bodies will continue to be authorised and regulated by the relevant approved regulators. Part 5 of the Act provides for these bodies to be licensed as “special bodies” once the licensing framework for ABS is established and the transitional arrangements end.

8.2. In that event, licensing authorities – including the LSB – will be able to take a different approach to the licensing and regulation of these bodies. In addition, they will also be able to modify their licensing rules for “low-risk bodies” with less than 10% non-lawyer management and ownership.

Not-for-profit bodies and community interest companies

8.3. In deciding whether to modify their rules, the licensing authority must take account of the customer groups to which legal services are provided, and the extent to which reserved and non-reserved legal activities are provided. Citizens Advice Bureaux and Law Centres make an important contribution to providing access to justice for disadvantaged consumers, not least as major providers of legal aid funded work. Complex areas, such as immigration advice, also involve high levels of not for profit involvement. So regulators may decide to exercise caution about introducing requirements that could add costs and complexity to the service they provide. Equally, however, they will need to take account of the backgrounds of the clients concerned and any relative inability to access justice except through such services: the need for protection may be greater, even if the organisations providing the service carry intrinsically less risk of detriment.

8.4. In determining the regulatory approach, the licensing authority should take an overall view about the risks associated with particular special bodies and their clients. A particular risk for some special bodies might be variable governance, given they may rely on volunteer Board members and have only a small number of paid employees. Other risks

which could apply to special bodies (as with other legal services providers) include poor quality advice from in-house lawyers, inadequate systems of complaints-handling, and a lack of clarity about handling client accounts in the event of the organisation being closed. That said, in the case of most special bodies, the risk of consumer detriment from conflicts of interest may be low, in the absence of direct commercial pressures. LSC commissioning also plays a role in driving high quality standards so we will engage further with them on how this does and could interact with regulation.

8.5. On the other hand, there could be potential benefits from organisational level regulation for lawyers employed by a special body, as it would make clear that all managers and/or the Board of the body have responsibility for managing its risks, not just the lawyers. Entity-based regulation might also be simpler from a consumer perspective and would be consistent with the broader evolution in legal services regulation outlined in Chapter 6.

8.6. If licensing authorities do license special bodies, they might learn from the approach taken by other regulators to not-for-profit organisations (see box). In particular, it is worth considering the merits of "group licensing" of networks of not-for-profit bodies, as it could reduce the regulatory burden on small local organisations. However, if there were considerable variations in the risk profiles of each organisation within a "group" – for example of individual Law Centres – this may not be an appropriate approach, or it might require the relevant national organisations to take on greater "self-regulatory" responsibilities.

8.7. The transitional protection for non-commercial bodies will only be removed by the Lord Chancellor on the recommendation of the LSB. So we would only make such a recommendation if we were satisfied that licensing of special bodies was in the interests of consumers and after a licensing authority has suitable licensing rules in place to accept such applications.

Regulation of not-for-profits by FSA and OFT

The FSA has a specific sourcebook for the regulation of credit unions. This tailors many of the key features of the FSA regulatory regime for firms – including solvency rules, senior management authorisation and responsibility, and quarterly returns – to credit unions. In addition, credit unions are subject to the core FSA requirement to treat customers fairly, they must have complaints procedures in place, and dissatisfied members have the right to submit complaints to the Financial Ombudsman Service. Furthermore, in the event of a credit union failing, savers can get compensation from the Financial Services Compensation Scheme.

Licensing authorities may also wish to explore the approach taken by the OFT to licensing not-for-profit providers of consumer credit. Where it better serves the public interest than obliging each affiliated organisation to apply separately for a standard licence, the OFT is willing to issue a group licence to a single responsible body. Citizens Advice has a group licence for its network of bureaux.

Trade unions

8.8. The Act takes a different approach to trade unions relative to other special bodies. Section 15 provides a specific exemption from the regulatory system for the provision of legal services by trade unions to their members. This covers services provided in connection with the trade union member's employment including workplace advice and representation. Individual lawyers employed by trade unions are subject to the conduct rules of their relevant regulator, and trade unions are governed and operate under their own legislative framework.

8.9. So the requirement to seek an ABS licence would only apply to trade unions if they choose to offer legal services to members of the public other than their members. Even in this event, Section 105 of the Act specifies that the requirements on other bodies to designate a HoLP and a HoFA will not apply to trade unions. Trade unions have also been restricted from the scope of the Schedule 13 regulations regarding the ownership of licensed bodies.

8.10. The Trades Union Congress currently anticipates that applications from trade unions to become ABS are unlikely. However, given that such

applications are feasible and, in this eventuality, unions would be in competition with other regulated legal services providers, licensing authorities need to consider whether other aspects of their licensing rules should be retained when dealing with any such application. Again, the licensing authority should start from an assessment of any risks associated with trade unions offering legal services to non-members.

Low-risk bodies and LDPs

8.11. Section 108 defines a “low risk body” as one with less than 10% non-lawyer managers and owners. Like other special bodies, these bodies may seek a lighter-touch approach to licensing from the appropriate licensing authority. The licensing authority will need to determine whether the level of risk of a licensed body with a small proportion of non-lawyer owners/managers is such that a significantly modified licensing regime is appropriate. It will also need to consider how this fits with its broader approach to regulating and managing legal practices and ABS.

8.12. The SRA recently permitted LDPs to include up to 25% non-lawyer managers. So, some of the management structures which are permitted under the current regulatory framework (i.e. those with more than 10% but less than 25% of non-lawyer managers) may require an ABS licence and will not be categorised as “low-risk” under the Act. This raises transitional issues so we are interested in views as to whether the LSB should consider using its right to recommend to the Lord Chancellor that bodies with less than 25% non-lawyer managers could be prescribed as special bodies. We would first need to establish if the experience suggests that these bodies represent a low-risk of consumer detriment.

8.13. **We intend to address special bodies further in future consultations, but at this stage we would welcome views about the type and degree of risks associated with special bodies and the appropriateness of organisational licensing. We would particularly welcome views from not-for-profit organisations and consumer groups.**

Question 26 - What are the risks to the consumer associated with the delivery of legal services by special bodies and which more general risks are less relevant to these bodies?

Question 27 - Is it in the consumer interest to require special bodies to seek a licence, and if so, what broad approach should licensing authorities take to their regulation?

Question 28 - Are there any other issues that you would like to raise in respect of ABS that has not been covered by previous questions?

Annex – List of questions

Question 1 - What are your views on whether the LSB's objective of a mid-2011 start date for ABS licensing is both desirable and achievable?

Question 2 - How do we ensure momentum is maintained across the sector towards opening the market?

Question 3 – What are your views on whether the LSB should be prepared to license ABS directly in 2011 if necessary to ensure that consumers have access to new ways of delivering legal services?

Question 4 - How should the LSB comply with the requirement for appropriate organisational and financial separation of its licensing activities from its other activities?

Question 5 - How do you expect the legal services market to respond and change as a result of opening the market to ABS?

Question 6 - In what ways might consumers of all types – including private individuals, small businesses and large companies – benefit from new providers and ways of delivering legal services?

Question 7 - What opportunities and challenges might arise for law firms, individual lawyers, in-house lawyers and non-lawyer employees of law firms as a result of ABS?

Question 8 - What impact do you think ABS could have on the diversity of the legal profession?

Question 9 - What are the educational and developmental implications of ABS and what actions need to be taken to address them?

Question 10 - Could fewer restrictions on the management, ownership and financing of legal firms change the impact upon the legal services sector of future economic downturns?

Question 11 - What are the key risks to the regulatory objectives associated with opening the market to ABS and how are they best mitigated?

Question 12 - Are there particular types of business structure or model which you consider to present a particular risk to the regulatory objectives?

Question 13 - What conflicts of interest do you think might arise in relation to ABSs and how should they be managed?

Question 14 - How should licensing authorities approach entity-based regulation and what are the main differences from the traditional focus on regulating individuals?

Question 15 - Do you agree with our view that licensing authorities should take a risk-based approach to regulation of ABS, and if so, how might this work in practice?

Question 16 - What is your preferred balance in regulating ABS between a focus on high-level principles and outcomes and a more prescriptive approach?

Question 17 - What are the advantages and disadvantages of a requirement on ABS to have a majority of lawyer managers?

Question 18 - What are your views about how licensing authorities should determine whether a person is a “fit and proper person” to carry out their duties as a HoLP or a HoFA?

Question 19 - What is the right balance between rejecting “higher-risk” licensing applications and developing systems to monitor compliance by higher-risk licensed bodies?

Question 20 - How should regulators ensure a level playing-field between regulated legal practices and licensed bodies?

Question 21- How should licensing authorities approach the access to justice condition, and do you agree that it is unlikely that many licences should be rejected on the basis of the condition?

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Legal Services Board
7th Floor
Victoria House
Southampton Row
London WC1B 4AD

T 020 7271 0050
F 020 7271 0051

www.legalservicesboard.org.uk