

Alternative business structures: approaches to licensing

Response by the Council of Mortgage Lenders

to the Legal Services Board consultation paper on draft guidance to licensing authorities on the content of licensing rules

18 February 2010

Introduction

1. The Council of Mortgage Lenders (CML) is the representative trade body for the mortgage industry in the UK. Our 109 members account for around 94% of the assets of the mortgage market, and their activities encompass all forms of housing tenure – home-ownership, low-cost home-ownership, buy to let and private and social rental.
2. We are not experts in the proposed functioning of alternative business structures (ABSs) or the regulatory regimes of those approved regulators that could licence ABSs. As such, we are not in a position to answer the detailed questions posed within the consultation paper. However, our members are experiencing grave problems arising from very high levels of solicitor fraud which we believe highlight shortcomings in the present regulatory process.
3. We wish to ensure that the regulation of ABSs does not expose our members to further regulatory risks and threats.

General points

4. We believe that the majority of solicitors are highly professional and competent. We have a number of associates who are law firms. We strongly support the work that those organisations carry out.
5. Unfortunately, however, not all of our members' relationships with solicitor firms are wholly positive. Members report that they are experiencing significant levels of solicitor related fraud. We are discussing this with the Solicitors Regulation Authority (SRA) and the Law Society. We believe that a direct impact of solicitor related fraud is the need to review the current regulatory system with a view to potentially significant changes. It is important that where detriment to clients is evident, lessons should be learned to ensure that suitable regulatory provisions are in place to prevent weaknesses from re-occurring.
6. Given that the fraudulent activity reported to us has been carried out by traditional law firms within a well-established regulatory regime, we are concerned about the consequences of potentially higher-risk ABSs subjected to a reduced level of regulatory scrutiny.
7. Particular areas of concern are:
 - An outcomes-focussed approach at the expense of more detailed oversight of an ABS's systems, processes and methods of work;
 - A lack of appreciation of the challenges faced by commercial clients; and
 - A licensing regime that may not have enough safeguards to effectively licence and monitor new, higher-risk business models and functions.
8. Given our members' reliance on solicitors and conveyancers, it is vital that the Legal Services Board (LSB) and licensing authorities (LAs) build and maintain a regulatory regime that engenders confidence in the profession.

Outcomes-focussed regulation

9. We are pleased to note that the LSB does not wish for its proposals to equate to 'light touch'. The LSB is also correct to say that licensing authorities should adhere to better regulation principles and that this should be achieved through a 'risk-based approach'.

10. However, a key element of a risk-based regulatory approach is sufficient oversight of a regulated firm's systems, processes and operational approaches. If an outcomes-focussed regulatory regime is pursued in lieu, rather than in tandem with this more detailed oversight, it is difficult to see how LAs will be able to develop sophisticated approaches to determine which ABSs, business models or functions pose the highest-risk. This may represent 'light touch' regulation in all but name.

11. This also presents a danger, be it through phraseology or intention, of an LA intervening only once the point of 'outcome' and thus potential client detriment has been reached. We are highly doubtful as to whether this proposed approach will be better able to pre-emptively stem problems similar to those experienced by our members. This is particularly true of questionable practices within ABSs that are not causing detriment to the client, but pose sufficient risk of doing so in future.

12. This general move towards outcomes-focussed regulation for the profession, as also proposed by the SRA in its recent consultation, will be of increasing concern to our members, most of which are regulated by the Financial Services Authority (FSA). Whilst the FSA remains a principles-based regulator, it is moving towards a more 'intrusive and intensive' regime for the mortgage market. Aside from our concerns over some of its proposals and timings for conduct of business reform, we welcome the FSA's change in approach. There is a risk therefore that if the LSB and SRA push ahead with their proposals, there will be an imbalance between (and a potential widening of) the regulatory scrutiny imposed upon solicitor firms and, as their clients, mortgage lenders.

Commercial clients

13. We support the LSB's proposal that consumers of legal services provided by ABSs should be afforded the same protections as consumers of traditional law firms. This should be a minimum requirement.

14. However, we are concerned that, in referring to 'consumers' throughout the consultation paper, the LSB does not recognise the discrete pressures and risks faced by commercial clients. Indeed, the Office of Legal Complaints' draft remit will prevent all but the smallest commercial enterprises acting as complainants, creating a disparity between the rights of commercial clients and consumers.

15. Furthermore, the LSB and LAs must appreciate that when a commercial client suffers detriment, it is not just that firm that is affected – detriment can potentially have wider ramifications for the market and subsequently individual consumers.

16. In the case of solicitor led fraud such ramifications are spreading to solicitors themselves.

17. Our members represent a significant client base for solicitors and, potentially, ABSs. As highlighted, we have written to the SRA and the Law Society setting out our concerns about solicitor-driven fraud in the mortgage market. Unless regulatory controls can give lenders sufficient assurance that fraud will be prevented and combated, they are likely to continue looking at their own panel controls and restrictions. In the absence of clear effective regulation and licensing, lenders are likely to be extremely nervous of a system that could allow fraudulent solicitors to practice in the same firm as other professionals involved in lender fraud.

18. Aside from conveyancing, claims management companies (CMCs) are creating significant administrative burden for our members. The quality of work carried out by some such companies – many of which are solicitor firms – is of a very poor standard. In some instances, lenders are incurring time and financial costs in clearing claims with the Financial Ombudsman Service that do not even emanate from their own customers. This is exacerbated by the propensity of 'quick-entry quick-exit' firms latching onto 'hot topics' perceived to be a worthy of claiming against.

19. The licensing of non-solicitor owned ABSs in these areas will give our members further concerns, which may not be allayed by either the proposed licensing or regulatory regimes. In light of these concerns, both a robust framework for PII and a compensation fund that does not present barriers to commercial clients are crucial.

Licensing

20. We welcome the LSB's proposal requiring all ABS owners, Heads of Legal Practice (HoLP) and Heads of Finance and Administration (HoFA) undertake 'fitness' tests. Strong perimeter controls will be critical to identifying and deterring unscrupulous individuals from entering the market. We agree that this test should be consistent across all LAs, although would argue that additional checks should be adopted for higher-risk business models (such as CMCs).

21. The challenge for LAs will be to ensure that the ownership of ABSs and suitability of key individuals is monitored on an ongoing basis. Whilst a licence will obligate an ABS to inform the relevant LA of any changes in circumstance, this could be difficult to manage in practice – particularly when considering the number of potential ABSs, the resources of the respective LAs and the general move towards outcome-focussed regulation. It would be helpful to know what sanctions would be taken if an ABS did not inform its LA of such changes in circumstance.

22. Transparency is another key concern for our members. Sufficient safeguards need to be in place to either: prevent non-compliant or dubious ABSs from closing down and reopening under a different guise with more or less the same personnel and business practices; or, at the very least, allow potential clients to track individuals through the profession.

23. Tracking solicitors who have been subject to regulatory action already presents problems. This is likely to be more of a concern in the case of ABSs, given the reduced regulatory oversight of individual non-solicitor owners. We would argue that names of individuals that have passed a fitness-to-own test, in addition to disqualification notifications, should be made available either publicly or on request.

24. We are concerned that the LSB intends that LAs should only place restriction on specific types of ABS activity unless there is 'clear strong evidence' of that activity causing 'significant harm'. Given the high levels of solicitor fraud that our members are experiencing we would suggest that an area of risk is residential conveyancing.

25. It is vital that LSB and LAs establish a cautious approach at the outset when assessing new market entrants, business models and functions. This is particularly true of conflicts of interest arising from new business models. From a mortgage lender's perspective, an ABS that contained a combination of solicitors and other professionals identified as being key players in mortgage fraud would present a significant risk.

26. In addition, we would ask that the LSB take note of our concerns over the conduct of CMCs.

Regulatory provisions

27. The regulatory provisions in place for traditional law firms should be seen as an absolute minimum standard for regulating ABSs. We are concerned that the current level of regulation has been insufficient in preventing or managing the problems our members have faced with some legal services providers.

28. Any focus on an entity rather than an individual, as the LSB is proposing, will need to recognise that the owners of an ABS (or any firm) will invariably be the driving forces and therefore must have a degree of regulatory accountability. We support the LSB's proposal that an individual should be banned from being a HoLP, HoFA, manager or employee of an ABS if found to have breached the terms of a licence. However, the determination and, more importantly, the prevention of such scenarios will depend on a more thorough oversight of an ABS's processes and methods of work. We are concerned that this may not be fully achievable in an outcomes-focussed regime.

29. This focus on ABSs will need to be strengthened if regulation of non-lawyer controlled ABSs is to be equitable with lawyer controlled ABSs and traditional law firms given the ongoing scrutiny of individual lawyers' conduct.

Comments

If you have any comments or queries on this response, please contact Nick Wood – nick.wood@cml.org.uk or 020 7438 8933.