

# Consultation response

## Legal Services Board: ABS – Approaches to Licensing

### Overview

1. The Legal Services Consumer Panel (the ‘Panel’) generally supports the proposals regarding Alternative Business Structures (ABS). The main points in our response are as follows:

- Promoting and protecting the interests of consumers should infuse all licensing rules and should be an obligation laid on each entity, its owners and senior management.
- The ownership test should include questions on: past disqualifications; criminal convictions and cases pending; and voluntary liquidation.
- We do not accept that there should be any aim for consumers to ‘make more informed choices about the risk they are prepared to take when obtaining legal advice’; instead there should be an explicit desired outcome of reducing the risk to consumers.
- As an interim measure, the Legal Services Board (LSB) should make all reserved and unreserved legal activities delivered by ABS subject to regulation.
- The LSB list of disqualified persons should be publicly available.
- The LSB should take an overarching coordination role in Licensing Authority monitoring of the impacts of ABS on access to justice.
- The twelve months grace period for special bodies is supported and Licensing Authorities should have

**freedom to adapt their regulatory regimes. All special bodies should fall within the jurisdiction of the Legal Ombudsman.**

2. The Panel wishes to be involved in the LSB’s future deliberations on ABS. In particular, we are interested in the regulation of reserved and unreserved legal activities, the development of indemnity and compensation arrangements, and the future regulation of special bodies. These areas have significant implications for consumer protection and/or access to legal services and we would welcome continuing dialogue on these issues.

### The LSB’s Proposals

3. The Consultation Paper outlines the LSB’s thinking on 15 main areas, including the regulatory framework, ownership rules and enforcement powers, and puts forward a range of detailed proposals, including:
  - Each ABS would be regulated based on a common set of core outcomes, irrespective of their Licensing Authority;
  - Non-lawyer owners and managers of ABS firms would be subject to a fit and proper person test;
  - Each ABS would need to have a Head of Legal Practice (HoLP) and a Head of Finance and Administration (HoFA) to ensure compliance with licensing requirements;
  - Complaints systems would be widened to deal with multi-disciplinary complaints and ABS customers would have access to the new Legal Ombudsman;

- Licensing Authorities would monitor the impact of ABS on access to justice; and
  - Special bodies, such as law centres, citizens' advice bureaux and independent trade unions, would be given a 'grace' period of 12 months to make the transition to being regulated ABS entities.
4. The Paper highlights areas where further work is needed. This includes how to manage indemnity and insurance requirements and how to regulate the ABS firm provision of reserved and unreserved legal activities.

## The Panel's Response

### Structure of Licensing Framework

5. The regulatory objective of protecting and promoting the interests of consumers should infuse all licensing rules and should be an obligation laid on each entity, its owners and senior management. Licensing Authorities should set principles for how risks are identified, and also for how clients' interests are protected and promoted.
6. All Licensing Authorities should have the same core outcomes. This should provide consistency in the outcomes expected for consumers and reduce the risk of Licensing Authorities offering 'easier' regulatory regimes to attract applicants.
7. Whilst the division between individual and entity regulation appears appropriate, there are two additional matters which should be included in the 'entity level considerations' list (para 62):
- The first is the financial viability of a firm. When a law firm fails for financial reasons, it will often be consumers who will suffer (e.g. they may need transfer their case to a new lawyer, may face significant delays or may face temporary or permanent financial loss if the firm

has not protected client funds). Whilst regulators should not seek detailed information on a firm's financial or capital status, Licensing Authorities should require notification if a firm is facing financial issues, such as failing to meet banking covenants, late payments to suppliers, or serious loan defaults. Such information would provide early 'warning signs' upon which a Licensing Authority could act, and provide an additional layer of consumer protection.

- The second is the referral arrangements of a firm. There needs to be consistency in consumer protection and transparency. Changes may be needed following the review of referral arrangements. However, in the interim, ABS firms should be subject to the same disclosure requirements as traditional law firms regulated by the SRA.

### Ownership, HoLP and HoFA Tests

8. A consistent 'fit and proper person' test should be applied by all Licensing Authorities to potential owners, HoLP and HoFA, irrespective of whether they are an authorised person. The HoLP and HoFA should be able to be the same person.
9. However, some of the required information proposed for the test might be difficult to obtain (such as checking on whether a person has been disqualified as a director once the period of disqualification has ended). To avoid undermining the test, all questions should have verifiable sources and be able to be enforced.
10. There are a number of additional questions that the fit and proper test should include:
- "whether an applicant has previously been disqualified by any Licensing Authority from being a HoLP, a HoFA, a manager or an employee of a different ABS firm." This would militate against a disqualified person establishing ABS

firms under new Licensing Authorities following disqualification by another.

- *“whether the person or body is, or has been, a ‘parent’ person or body of subsidiary entities that are subject to any criminal convictions or cases pending in the UK or elsewhere.”* This may assist in identifying any attempts by a main company to create subsidiary companies between which accumulated convictions/enforcement actions could be spread.
  - *“whether the person has ever been a senior officer in a business that has gone into voluntary liquidation without reimbursing its creditors.”* This would identify traders who may have deliberately gone into liquidation and re-emerged under a different name and with different directors.
11. Licensing Authorities must be able to refuse to authorise any individual who knowingly makes a false declaration (para 92). Further, Licensing Authorities should be able to cancel authorisations where an individual is found to have deliberately omitted or withheld relevant information. This would ensure there is not a perverse incentive for applicants to omit statutorily requested information due to the penalty for doing so being less than the penalty for the primary offence.
  12. For consumer protection, those who can exert significant control over a firm and potentially prejudice the service offered should be identified. However, transparency requirements need to balance the risk of influence with the costs of identification. For example, this could particularly apply in instances where an owner is not a single person but is instead a shareholding trust; if the trust owned more than 10%, but each individual beneficiary owned less than 10%, the costs of identifying them may outweigh their risk potential.

## Duties owed to the Court and Client

13. All listed ABS must have a clear obligation to ensure that *‘a duty to a shareholder or other stakeholder does not compromise the duties owed to the court and to a client’*. This obligation should be an explicit rule that is applied by Licensing Authorities to all ABS, and not be limited to listed companies.

## Indemnity and compensation

14. We do not accept that there should be any aim for consumers to *‘make more informed choices about the risk they are prepared to take when obtaining legal advice’* (outcome 4, p32). Such an outcome is almost certainly unrealistic, and may indeed be undesirable. Most consumers, especially those who use lawyers rarely, expect obtaining legal advice to be risk-free. There should therefore be an explicit desired outcome of reducing the risk to consumers.
15. The questions around the regulation of PII go beyond the ABS context. Given that appropriate arrangements are essential for robust consumer protection, the establishment of a dedicated Taskforce to look at these issues is supported.

## Reserved/unreserved activities

16. It is essential that consumers have equivalent protection, whether they obtain legal services from an ABS firm or a traditional law firm. The LSB is due to consider the definitions of reserved and unreserved activities, and how these activities will be regulated, during 2010.
17. In the interim, the LSB should make all legal activities (both reserved and unreserved) delivered by ABS firms subject to regulation. This will assist in ensuring that consumers are not at risk of less protection and redress whilst the wider issues are considered. This is consistent with the Solicitors Regulation Authority’s

approach to regulating solicitor firms,<sup>1</sup> and the Council of Licensed Conveyancers proposed changes to its regulatory regime.<sup>2</sup>

18. Should the LSB decide that only reserved activities will be regulated, there must be mechanisms to ensure consumers understand their rights and the differences in regulation. This needs to include consumer education, kite-marking and/or 'health warnings'/disclosure boxes on contracts for legal services. There must be no circumstances where clients of ABS firms have no recourse to independent redress.

### LA Enforcement and Penalty Powers

19. We support the use of unlimited financial penalties. However, the LSB needs to monitor the use of penalty powers, to ensure Licensing Authorities do not distort the market by imposing inconsistent or disproportionate penalties.
20. Licensing Authorities must also have an appropriate suite of enforcement powers to ensure that penalties can be proportionate, and with provision for escalated and staged enforcement action. It is equally important that perverse incentives in the sanctioning regime, such as risk-aversion, are avoided.
21. The LSB's list of disqualified persons should be publicly available, as well as be searchable online. This transparency acts as a form of 'public sanction' to those who disregard the regulatory regime, as well as a source of information for consumers and regulators.

### Access to justice

22. ABS applicants and Licensing Authorities need to understand how a new firm can improve access to justice, and new firms need to communicate what they are offering to users. ABS applicants should have to demonstrate an understanding of the

services needed by consumers, and how their services will meet these needs.

23. Pressure to improve access to justice needs to apply equally to ABS firms and traditional law firms. The introduction of ABS provides an opportunity to examine access to justice issues but ABS firms cannot be expected to do more than traditional law firms. Ideally, the LSB should be working with Approved Regulators to identify how the needs of different consumers are being met, and whether all consumers are able to fully participate in the market.
24. In defining Access to Justice, the importance of face to face contact for some consumers must be recognised. Some consumers can be excluded by an over-emphasis on online services and must have their needs addressed. Again, this is an issue that cuts across the whole legal sector, rather than being ABS-specific.
25. The LSB should take on the coordination role over Licensing Authority monitoring of the impacts of ABS on access to justice. This will allow the sector-wide monitoring of impacts, as well as opportunities to share the lessons learnt by Licensing Authorities.

### Special Bodies

26. Whilst accepting the proposed transitional arrangements for special bodies, guidance and practical help may be needed to ensure that all such bodies are ready within the time limit.
27. Consumers who obtain legal services from special bodies must have the same protection and access to redress should something go wrong as consumers using traditional or ABS firms. A balance will be needed between such safeguards and ensuring that the regulatory burden placed on special bodies does not limit their ability to offer legal services, especially as their

clients may have greater needs, and less access to legal services and to justice.

28. Special bodies should be able to 'opt-in' to the new Legal Ombudsman during the transition period. However, in the longer term, all special bodies should be party to the Legal Ombudsman scheme.

### Complaints

29. Complaints must be monitored and reviewed, so that lessons learnt are fed back into service delivery and regulatory activity. This should be both for first-tier complaints and for those taken to the Legal Ombudsman. An additional outcome should be included under complaint handling, such as: *'Effective feedback loops are in place to ensure lessons are learnt from complaints and service delivery adjusted accordingly'*.
30. The feedback would allow greater emphasis to be given to the positive aspects of complaints handling, with analysis of past complaints used to improve the business. It would also allow the LSB to encourage Licensing Authorities to look for and disseminate information on best practice.

### Diversity

31. Whilst the diversity and the legal workforce proposals are welcome, the introduction of ABS should aim to increase the diversity of consumers accessing legal services. This should be an explicit desired outcome under either, or both, 'Access to Justice' and 'Diversity'. Dual aims to increase the diversity of the workforce and users should assist the delivery of legal services that more effectively meets the needs of different consumers.

### Duration of ABS licence fees and terms

32. Whilst there are benefits to a fixed fee in terms of entity certainty, licence fees should

be cost reflective to ensure that there is appropriate funding for all required checks and compliance activities.

33. For licence terms, it is unclear whether Licensing Authorities will also have the option of 'suspending' a licence rather than just the more significant step of revocation.
34. Compliance monitoring will be important in ensuring that ABS firms meet the regulatory objectives and deliver the desired outcomes. Whilst it is not appropriate for the LSB to prescribe how each Licensing Authority undertakes monitoring, the LSB has to be confident that Licensing Authorities have effective monitoring in place.

### Regulatory Overlaps

35. Regulatory overlaps will need to be managed to minimise confusion and costs, which should be achieved through the proposed framework Memorandum of Understanding.
36. The LSB should encourage cooperation and information sharing with other redress schemes (eg those for insurance businesses; estate agents; local government), as well as with other schemes that collect and collate consumer complaints (eg Consumer Direct, Citizens Advice).

## February 2010

<sup>1</sup> Code of Conduct 2007, <http://www.sra.org.uk/solicitors/code-of-conduct.page>

<sup>2</sup> Council of Licensed Conveyancers (2010) *Proposed Application by the CLC to the Legal Services Board as an Approved Regulator to regulate Licensed Conveyancers practice in the exercises of Rights of Audience and Conduct of Litigation*, CLC Consultation Paper February 2010, <http://www.conveyancer.org.uk/yogiP/UploadFiles/ConsultationPaperTwoApplicationtoRegulateLicensedConveyancersintheExercisesofRightsofAudienceandtheConductofLitigation.pdf>