

# Alternative business structures: approaches to licensing

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Guidance to licensing authorities on the content of licensing  
rules

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# Guidance on Licensing Rules

## Introduction

1. This document sets out the Legal Services Board's (LSB's) guidance to Licensing Authorities (LAs) on their approach to regulating Alternative Business Structures (ABS). Underpinning the LSB's approach is our belief that legal services providers should be free to innovate and develop new ways of working to meet consumer needs and demands, whatever their chosen business model. So ABS licensing rules should not seek to restrict commercial activity unless there is evidence of consumer detriment that requires regulation.
2. This document therefore specifies the outcomes that all LAs must seek to achieve when regulating ABS, with particular focus on consumer protection across a wide range of policy areas.
3. We do not consider that this in any way equates to so-called "light touch" regulation. Effective, risk-based enforcement by LAs (and ARs) backed by appropriate sanctions against transgressors will ensure that consumers are protected and that they have confidence in their legal service providers.
4. This guidance has been informed by extensive consultation and discussions with interested parties. The way in which we have taken into account the results of the consultation and an explanation of why we have arrived at a particular policy position has been published at the same time as this document.

## **Regulating for outcomes**

5. We expect the regulation of ABS to be based primarily on clear outcomes supplemented by guidance, with rules where there is only one appropriate way to ensure consumer protection and broader public interest. In order to do this consistently across all LAs, we expect LAs to explain how they expect their licensing rules will support the following outcomes and how they will monitor whether the outcomes are being achieved.

### ***Behavioural integrity***

6. Both lawyer and non-lawyer employees, office holders and owners behave in ways that ensure that:
  - justice and the rule of law are upheld;
  - they act with integrity and respect the professional principles;
  - they act with independence and in the best interests of their clients, ensuring that confidentiality and client money are protected;
  - they provide good standards of service to all their clients; and
  - they are trusted by members of the public and do not behave in a way that undermines trust in the provision of legal services.

### ***Regulation***

7. Regulation is focussed on consumer protection. LAs' enforcement powers are targeted on areas of high risk and consumer detriment, act as an effective deterrent and are able to be used proportionately in response to a wide variety of compliance and enforcement issues involving both individuals and entities to reduce the risk to consumers.
8. Consumers are confident that their advisors are regulated appropriately.
9. LAs' approach to regulation provides a level playing field in which competitive pressures rather than regulation shapes the provision of legal services.

### ***Ownership***

10. Consumer confidence in ABS that are owned by non-lawyers is at least as high as other law firms.
11. LAs identify and manage any risks to the outcomes posed by owners and their associates.

### ***HoLP/HoFA***

12. High quality Heads of Legal Practice (HoLPs) and Heads of Finance and Administration (HoFAs) who come from a wide range of backgrounds and diversity reflecting the commercial decisions and commercial operations of the ABS as well as the statutory requirements.
13. Strong governance arrangements to:
  - provide HoLP and HoFA with access to CEO, Board, non-executives, LA whenever necessary;
  - ensure compliance with LSA and licence requirements;
  - ensure appropriate operating procedures; and
  - provide a mechanism for ABS staff to raise concerns which are acted upon appropriately.
14. ABS compliance with licence requirements is high, with minimum enforcement required by LAs.

### ***Indemnity and compensation***

15. Regulatory arrangements provide appropriate levels of redress and protection for consumers against negligence and fraud for the services being provided, comparable to those enjoyed by consumers of non-ABS firms, whilst not unduly restricting commercial activity.
16. Consumers are more informed about the risks and potential compensation for fraud and misconduct when obtaining legal advice from any legal service provider.

### ***Reserved and non-reserved legal services***

17. Different forms of commercial arrangements for ABS emerge and effective regulation provides the same levels of consumer protection for reserved and unreserved legal activities as in the rest of the market.

### ***Access to Justice***

18. ABS provide examples of innovative and flexible ways of providing a greater range of services and enhanced value for money for consumers.
19. Consumer awareness and understanding of their right to, and how to get, legal advice improves.
20. Consumer trust in the provision of legal services improves.

21. ABS provide examples of improving access to justice that can be used by ARs, LAs and the LSB as examples of good practice in improving access to justice in general.

### ***Appellate bodies***

22. One appellate body with sufficient resources and expertise to deal with complex issues whose processes and costs are transparent, efficient, fair and public.
23. The appellate body is able to draw from experience across a wide range of regulatory issues and is able to come to consistent decisions about similar issues.

### ***Complaints handling for ABS***

24. Consumers of legal services provided by ABS are afforded the same protections as consumers from non-ABS providers for first line complaints handling and access to the Legal Ombudsman.
25. Referral of complaints to other bodies is done in a way that minimises inconvenience for consumers.

### ***Diversity***

26. ABS allow the provision of legal services to develop in ways that help encourage diversity.
27. Better information on diversity allows consumers a clearer insight into the providers they choose, provides individuals the information needed to make an informed decision about their careers and allows law firms to differentiate themselves in a liberalising market.

### ***Transitional arrangements for LDPs and other similar bodies***

28. There is a smooth transition for firms that currently have non-lawyer managers or owners who wish to become ABS.

### ***Regulatory overlaps***

29. A single framework Memorandum of Understanding (“MoU”) is implemented by all relevant bodies and provides a mechanism to resolve overlaps in ways which:
  - provide the best form of consumer protection and redress;
  - minimise confusion for market participants; and
  - reduce/remove conflict in future.

## General

30. This guidance relates to the licensing rules of LAs. It applies to the licensing rules of prospective LAs as well as changes that LAs, once designated, may wish to make to their rules. The process for becoming a LA is covered in a separate document. Part of that process will be to consider overall the applicant's competence as a LA. The term "licensing rules" is used in the Act. We consider that this can include rules, principles, outcomes, guidance and the broader regulatory arrangements of a LA. Where this guidance is silent on particular requirements of the Act, it will be for the prospective LA to explain its approach to the requirement and how in its view its licensing rules are consistent with the regulatory objectives and the better regulation principles.
31. The LSB will take into account the extent to which a prospective LA has complied with this guidance (or any subsequent supplementary or replacement guidance) when considering whether to approve an application to become a LA or agree changes to a LA's licensing rules. The LSB anticipates that it will issue further guidance on appellate bodies and indemnity and compensation following further discussions with all parties. If the applicant's rules are inconsistent with any LSB guidance, it must explain why and provide sufficient evidence to support the need for a different approach. The LSB will use its judgment to decide overall whether it is appropriate to approve the licensing rules as part of the application to become a LA.
32. LAs must assure themselves that their licensing rules are consistent with other requirements such as the Framework Services Directive and include a statement to that effect.
33. All LAs are also approved regulators and are bound by the regulatory objectives. These are:
  - 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;
  - encouraging an independent, strong, diverse and effective legal profession;
  - increasing public understanding of the citizen's legal rights and duties;
  - promoting and maintaining adherence to the professional principles.
34. We expect that licensing rules are able to demonstrate how those rules met the regulatory objectives.

## Legal Services Act requirements

35. The next sections follow the relevant sections of the Act and there is therefore some overlap and duplication in order to ensure that all relevant sections have been included. In order to comply with the Code of Practice on guidance on regulation<sup>1</sup> (which does not apply to LSB in giving guidance to LAs) LAs should consider whether their own rules and guidance should more closely follow their own application process, with cross references to relevant sections of the Act.
36. LAs will regulate both individuals and entities, and will have enforcement powers that they can use against both individuals and entities. It is important that licensing rules are clear about the importance of compliance for both individuals and entities and what is expected of both. But we do not consider that it is possible (or necessary) for us to define exactly where the responsibilities of the individual end and those of the entity begin since there should be considerable interaction between the two.

## LSA Section 83 requirements

### **Requirement:**

*Licensing rules of a Licensing Authority must contain appropriate qualification regulations in respect of Licensable Bodies to which the Licensing Authority proposes to issue licences (section 83(5)(a) and section 21(2))*

### **Guidance:**

37. Qualification regulations are defined in section 21 of the Act. In general we consider that the qualifications and experience of those who work in an ABS are matters for the ABS to decide, based on the requirements of its business and the expectations of its staff. We do not consider that LAs should set qualification regulations for people who work in ABS that are different to any they set for people who work in non-ABS. We consider that the qualifications and experience of the HoLP and HoFA are, broadly, matters for the ABS to decide. However, given the importance of the roles we expect that the LA would be looking for high quality individuals to fill these roles. The Act requires that the HoLP must be an authorised person in relation to one or more of the licensed activities. It may be appropriate to have a requirement for targeted continuing professional training for one or both of these roles, although we consider that the case for any such requirement is likely to be stronger for the HoLP.
38. Unless they are demonstrably inappropriate to fulfil their role, we would not expect a LA to decline to approve an application for a HoLP or HoFA. Licensing authorities may legitimately have expectations that having an accountancy qualification may be the normal requirement for the HoFA in many cases,

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<sup>1</sup> <http://www.berr.gov.uk/files/file53268.pdf>

although we consider that there should be flexibility to ensure that requirements are proportionate in relation to a firm's size and risk profile. In any case, the information about the HoLP/HoFA's qualifications and experience should be used to inform the LA's risk assessment of the ABS in order to target their monitoring and enforcement proportionately. We expect LAs to provide guidance on these issues, including the way in which they will approach their risk assessment. We consider that it is appropriate for that risk assessment process to take into account the competence and credibility of the HoLP/HoFA in understanding the ABS business and the regulatory requirements. It may be appropriate in some circumstances for the LA to interview the HoLP/HoFA as part of their designation.

39. Further guidance on the requirements for HoLP and HoFA are in paragraphs 77 to 87.

**Requirement:**

*Licensing rules of a Licensing Authority must contain provision as to how the Licensing Authority, when considering the regulatory objectives (in compliance with its duties under section 3(2) or 28(2)) in connection with an application for a licence, should take account of the objective of improving access to justice (section 83(5)(b))*

**Guidance:**

40. Licensing authorities must have regard for all the regulatory objectives and we expect that the licensing rules would be able to demonstrate how they have taken these into account. This will need to include the impact of the rules on the diversity of profession.
41. With regard to improving access to justice, there are a number of changes already taking place in the legal services market that may have an impact on this regulatory objective. These include not just the introduction of ABS but also the way in which legal services are regulated and political, economic, social and technological factors. All these are likely to have an impact on access to justice in terms of, amongst other things, lower prices, better recognition of consumers' needs and different ways of delivering legal services. It is unlikely that any one factor will be able to be identified as the cause of any change in access to justice. We therefore expect ARs/LAs to monitor the various factors that influence access to justice across all those they regulate and to work with the LSB to understand the dynamics and interaction of these factors. We do not consider that it is appropriate to assess the impact on access to justice solely or mainly based on requirements such as the provision of face to face services, the number of traditional firms in a given area, or categories of legal advice provided. Nor should LAs define access to justice based on the categories of legal advice that an ABS wishes to provide.

42. In order to provide as level a playing field as possible, LAs must not place obligations on ABS concerning access to justice that they do not place on non-ABS, unless a specific risk to the consumer has been identified and there is strong evidence of consumer detriment not present in non-ABS. Many legal service providers will choose to undertake, for example, *pro bono* work. But unless there are equivalent requirements for non-ABS firms, it is not appropriate to place specific obligations on ABS to provide, for example, financial support to existing providers of legal services, or *pro bono* services. In order to be consistent with the principles of better regulation, LAs should not seek to duplicate other statutory requirements (e.g. competition law) in ABS licence conditions.
43. We expect LAs to ask licence applicants to explain how they anticipate they will improve access to justice. However, since it is likely to be difficult for applicants to predict the impact that they will have on access to justice in isolation, other than in exceptional circumstances, we would not expect a licence application to be refused on the basis of the response to this question.
44. Over time, we expect evidence to build up (by ARs, LAs and the LSB) that shows how access to justice changes. The LSB must include in its annual report how, in its opinion, the activities of licensing authorities and ABS have affected the regulatory objectives. We will therefore expect LAs to gather evidence of the approaches to access to justice taken by ABS.

**Requirement:**

*Licensing rules of a Licensing Authority must contain appropriate arrangements (including conduct rules, discipline rules and practice rules) under which the Licensing Authority will be able to regulate the conduct of bodies licensed by it, and their managers and employees (section 83(5)(c))*

**Guidance:**

45. We expect licensing rules to set out the LA's guidance on good governance and operating procedures including dealing with conflicts of interest. We expect LAs to use the individual ABS approach to conflicts of interest to inform the LA's risk assessment of the ABS. We expect a LA to provide guidance on how to manage conflicts of interest rather than to prescribe in detail how ABS should manage potential and actual conflicts.
46. We expect a LA to have a credible and effective compliance and enforcement policy (including transparency about all forms of enforcement action, both informal and formal) in its licensing rules. This should include an approach to risk assessment that enables it to identify developing risks and to respond quickly and effectively. In general, when carrying out enforcement action, a LA must take into account the Better Regulation principles. We consider that it is appropriate for LAs to also have regard to the Regulators' Compliance Code

which aims to embed in regulators a risk-based, proportionate and targeted approach to enforcement.

47. We consider that the LA should seek to resolve issues of non-compliance informally at first (unless the non-compliance is so serious as to merit immediate action). Such an approach will enable early resolution of a wide range of issues, some of which may be relatively minor. It may also enable resolution of more serious issues, saving resources for both the LA and the ABS, producing a satisfactory outcome more quickly for consumers and the ABS.
48. Licensing rules should set out the LA's approach to monitoring and information gathering. A LA should give examples of the circumstances in which it is likely to take action and the form of that action, without fettering its discretion. This should include how it takes into account the risk that is posed to one or more of the regulatory objectives and professional principles. In particular a LA may wish to state how it will take account of the following:
  - best regulatory practice including the requirement that its activities must be proportionate, consistent and targeted only at cases in which action is needed;
  - whether the act or omission has taken place over a long time or is part of a series of the same or similar actions or appears to be deliberate or vexatious or follows a failure to resolve the matter informally in a way that the LA considers satisfactory;
  - the seriousness of the act or omission and the impact (or likely impact) of it on consumers and those being regulated;
  - the desired outcome for consumers of taking action and whether that outcome is likely to be significantly beneficial compared to the impact of not taking action;
  - the likely impact on those being regulated by the LA and the likely impact on the wider provision of legal services including public confidence in those services and in the regulatory framework;
  - whether the resource requirements needed are proportionate to achieving the desired results; and
  - any other matters that it appears appropriate to take into account.
49. We expect that a LA's approach to enforcement will cover a wide range of issues that might result in a breach of licence requirements including, but not limited to:
  - people, including owners, who are no longer fit and proper;
  - divestment;

- failures in governance arrangements;
- allegations of fraud and dishonesty;
- provision of false, incomplete or misleading information to the LA either at the licence application process or subsequently;
- disqualification;
- dealing with allegations of improper influence;
- imposing supplementary requirements for an ABS that is identified as higher risk
- licence suspension or revocation
- failure to provide information to the LA;
- failure to pay any annual fee;
- its approach to financial penalties, including how it will act proportionately in setting the amount of any penalty on an individual or an entity or both; and
- which decisions, in addition to those prescribed by the Act, can be appealed to the appellate body.

50. The powers and requirements in Schedule 14 following an intervention are prescriptive and we expect a LA to follow them. LAs' licensing rules should ensure that they are able to intervene and/or suspend or revoke a licence in appropriate circumstances, including those in Schedule 14.

**Requirement:**

*Licensing rules of a Licensing Authority must contain appropriate indemnification arrangements (section 83(5)(d))*

**Guidance:**

51. As far as possible, ABS should be subject to the same consumer protection requirements as non-ABS firms. These should set minimum requirements for an appropriate level of consumer protection that reflect the risk posed by the activity (or activities) or type of client of the ABS. A tiered approach to the level of cover required is acceptable. ABS must have the flexibility to increase the level of indemnity as they see fit. The LA's indemnification requirements must be sufficiently flexible to allow other products and approaches to develop to meet changing market conditions. LAs can provide guidance on the types of arrangements that they would find acceptable but they must also consider alternatives to those arrangements if they are proposed by an ABS and consider any evidence that the alternative provides an equivalent level of consumer protection.

52. We expect LAs to provide evidence that shows that their indemnification arrangements remove where possible structural barriers to normal commercial activities such as issuing shares and share options, restructuring, mergers, acquisitions, closures and successor practices. Any remaining barriers must be objectively justified.
53. We expect LAs to ensure that they have arrangements in place with insurers (or other providers of indemnity cover) and other regulators to exchange information (in both directions) about suspected or actual fraudulent activity or dishonesty and that their enforcement procedures deal adequately with such allegations. It may be appropriate for LAs to require licence applicants to agree to information being disclosed to other bodies in order to detect or prevent fraud.

**Requirement:**

*Licensing rules of a Licensing Authority must contain appropriate compensation arrangements (section 83(5)(e))*

**Guidance:**

54. As far as possible, ABS should be subject to the same compensation arrangements as non-ABS firms. If an AR does not have compensation arrangements in place then we do not necessarily expect its LA to introduce them for ABS, providing the scope of its regulation remains the same and there is an evidence-based reason why they are not required that takes account of consumer protection issues. If this changes (for example by the addition of another reserved legal activity or holding client money) then it may be necessary to introduce compensation arrangements as part of the process for changing regulatory arrangements set out by the LSB.
55. We expect LAs to provide compensation arrangements that cover sufficiently the risk of fraud resulting in hardship to retail consumers and SMEs that is not covered by PII. We do not expect compensation arrangements to provide compensation for large businesses or financial institutions, although a LA may choose to include these in its arrangements. We do not consider that parent company guarantees are appropriate forms of compensation. This is because in the event that the parent company goes out of business or files for protection from creditors, consumers are likely to be left with no means of redress. Although letters of credit may provide more certainty than a parent company guarantee, LAs should bear in mind that they have to be carefully worded to ensure that they will actually provide money in circumstances where there has been fraud. LAs should also take into account the cost of providing a letter of credit and the extent to which they (or any other compensation arrangements) are an unnecessarily high barrier to entry.

56. Compulsory contributions to any arrangements must be shown clearly in a breakdown of the annual licence fee.
57. LAs must ensure that there is a requirement for ABS to make consumers more aware of the possible risks that can arise in obtaining legal advice, the protection that is available and the circumstances in which they may be left without any recourse.

**Requirement:**

*Licensing rules of a Licensing Authority must contain the provision required by Sections 52 and 54 (resolution of regulatory conflict) (including those provisions as applied by Section 103) (section 83(5)(f))*

**Guidance:**

58. LAs must set out the details of how they comply with this requirement. This includes how they will interact with other regulators (including any Memoranda of Understanding). We also expect LAs to identify any conflicts with other regulators' arrangements and the steps they have taken to try to resolve them.

**Requirement:**

*Licensing rules of a Licensing Authority must contain the provision required by Sections 112 and 145 (requirements imposed in relation to the handling of complaints) (Section 83(5)(g))*

**Guidance:**

59. Licensing rules on complaint handling must be consistent with any requirements issued by the LSB under s112 of the Act. They must ensure that the potential complexities of complaints handling for multidisciplinary practices do not have an adverse effect on the complainant. They must also take into account that there may be many different ways of dealing with complaints, and provide flexibility for an ABS to adapt how it deals with complaints to the needs of consumers. Regulatory requirements should build on best practice and, so long as the consumer's right to complain is protected, not undermine existing systems or create unnecessary requirements. LAs' requirements must include (but need not be limited to) the following:
  - the need to ensure that complaints are dealt with fairly, promptly, constructively and honestly;
  - the need to ensure that complaints against lawyers and non-lawyers are considered and that there is clarity of responsibility for complaint handling;
  - information to be given to complainants and the way in which complainants should be treated. This includes guidance on timescales for initial and subsequent communication and information about the role of the Legal Ombudsman;

- the way in which a member of staff being complained about will be treated; and
- the importance of record keeping.

**Requirement:**

*Licensing rules of a Licensing Authority must contain any other provision required to be contained in licensing rules by the Act (Section 83(5)(h))*

**Guidance:**

60. LAs must set out the details of how they comply with this requirement. In particular, the application should set out the rationale and justification where any additional measures are proposed.

## Schedule 11 requirements

### LICENSING PROCEDURE

#### Applications for licences and determination of applications

**Requirements**

*Licensing rules must make provision about the form and manner in which applications for licences are to be made, and the fee (if any) which is to accompany an application (Sch. 11, paragraph 1(1))*

*Licensing rules may make provision about:*

- *the information which applications must contain; and*
- *the documents which must accompany applications (Sch. 11, paragraph 1(2))*

*Licensing rules must make provision for those items set out in Schedule 11, paragraph 2*

**Guidance:**

61. LAs must publish their application process and make it as straightforward as possible. LAs must have regard to the regulations to be made pursuant to the Framework Services Directive which seek to ensure transparency of cost when licensing. We expect licence fees to be broadly cost-reflective and to allow for different annual licence fees for different types of ABS, although this should not be overly complex. LAs should publish their licence fees but retain the ability to charge additional amounts for particularly complex applications.
62. The Act requires a LA to make a decision whether to grant a licence within six months of first receiving the application. The LA must publish its target times for assessing licence applications and publish its performance on an ongoing basis.

## Review of determination

### **Requirement:**

*Licensing rules must make provision for review by the Licensing Authority of:*

- *a decision to refuse an application for a licence;*
- *if a licence is granted, the terms of the licence (Sch. 11, paragraph 3)*

### **Guidance:**

63. Every licensing authority must have a published, comprehensive and quick internal review system to consider representations against a decision to refuse a licence application and the terms or conditions of a licence. The review should be conducted by a person or people who have not been involved in considering the application itself. The process must be set out in the LA's licensing rules. It is for the LA to consider how far this should involve a review of the legal adequacy of the process undertaken or should constitute a re-assessment of the application. The appellate body will only hear appeals from those who have exhausted their options for internal resolution by the LA, or when the LA has failed to complete a review within its own timescales.

## Period of licence and renewal

### **Requirement:**

*The licensing rules may make provision:*

- *limiting the period for which any licence is (subject to the provision of Part 1 of Schedule 11 and of the licensing rules) to remain in force;*
- *about the renewal of licences, including provision about the form and manner in which an application for renewal is to be made, and the fee (if any) which is to accompany an application (Sch. 11, paragraph 4(1))*

*The licensing rules may make provision about:*

- *the information which applications for renewal must contain; and*
- *the documents which must accompany applications (Sch. 11, paragraph 4(2))*

### **Guidance:**

64. Licences should not be time-limited (other than if a temporary licence is issued – see paragraph 67) and so there will not be an annual renewal process.

65. However we expect that LAs will want to collect information about ABS in the same way that they would for non-ABS. The Act also requires LAs to collect an annual fee. It is therefore appropriate for licensing rules to make provision about data collection, although we would expect these to be similar to any information requirements on non-ABS.

**Requirement:**

*Licensing rules must provide that a licence issued to a Licensed Body by the Licensing Authority ceases to have effect if the Licensed Body is issued with a licence by another Licensing Authority (Sch. 11, paragraph 4(3))*

**Guidance:**

66. LAs must set out the details of how they comply with this requirement.

## **Continuity of licences**

**Requirements:**

*Licensing rules may make provision about the effect, on a licence issued to a partnership or other unincorporated body (“the existing body”), of any change in the membership of the existing body. The provision which may be made includes provision for the existing body’s licence to be transferred where the existing body ceases to exist and another body succeeds to the whole or substantially the whole of its business. (Sch. 11, paragraph 5)*

**Guidance:**

67. We expect LAs to include provision to enable either the:

- transfer of a licence, including the circumstances (if any) in which a licence can be transferred, the information that must be provided as a result of the transfer and the process that the LA will use to decide whether it remains appropriate for the body to continue to be licensed; or
- the issue of a temporary licence, including the circumstances (if any) in which the LA will grant a temporary licence (which may need to be before a change of ownership takes place) and the process for applying for a temporary licence.

68. It is for the LA to decide which approach or approaches is appropriate for it to best ensure consumer protection, facilitate commercial transactions and take into account the notification requirements in Schedule 13 to the Act. To retain maximum flexibility it may be appropriate for both options to be available, with the LA having the discretion to decide which approach is suitable for the circumstances of a particular case. It is acceptable for a LA to charge a cost-reflective fee for either approach.

## **Modification of licences**

**Requirement:**

*Licensing rules must make provision about the form and manner in which applications are to be made for modifications of the terms of a licence under Section*

86, and the fee (if any) which is to accompany the application (Sch.11, paragraph 6(1))

**Guidance:**

69. We expect LAs to publish the process for requesting licence modifications and that it will be as straightforward as possible. The process should indicate what information is required, give indicative timescales within which the LA will reach a decision and set out the appeal process. These fees should be broadly cost-reflective without being overly complex. We expect LAs to publish their fees but to retain the ability to charge additional amounts for particular complex applications.

**Requirement:**

*Licensing rules may make provision as to the circumstances in which the Licensing Authority may modify the terms of a licence under Section 86 without an application being made (Sch. 11, paragraph 6(2))*

**Guidance:**

70. It is appropriate for LAs to offer an indicative, but necessarily exhaustive, list of circumstances in which they might use their power to modify licence conditions without consent, perhaps as an enforcement tool or as an emergency measure before a wider investigation which may lead to the revocation of a licence. The appeal process should also be set out.

**Requirement:**

*Licensing rules must make provision for review by the Licensing Authority of:*

- *a decision to refuse an application for modification of the terms of a licence;*
- *if the Licensing Authority makes licensing rules under sub-paragraph 6(2), a decision under those rules to modify the terms of a licence (Sch. 11, paragraph 6 (3))*

**Guidance:**

71. We expect LAs to have a comprehensive and quick internal review system to consider these requests. Such a review should be conducted by a person or people who have not been involved in the decision itself. The process must be set out in the LA's licensing rules. It is for the LA to consider how far the process should involve a review of the legal adequacy of the process undertaken or should constitute a re-assessment of the application. Appeals to the appellate body would only be allowed from those who have exhausted their options for internal resolution by the LA, or when the LA has failed to complete a review within its own timescales.

**Modifications under section 106 or 107**

72. The LSB's current view is that the transitional arrangements for special bodies (section 23 of the Act) should remain in place for 18 months after other ABS

have been permitted. LAs' licensing rules should, therefore, contain a statement that they cannot accept applications made under section 106 of the Act. Once the LSB issues guidance on the approach to these bodies, LAs can consider whether they want to amend their licensing rules to enable them to license special bodies.

## STRUCTURAL REQUIREMENTS

### Management

#### **Requirement:**

*Licensing rules must require a licensed body to comply with the requirements set out in Schedule 11, paragraph 9 (Sch 11, paragraph 9(1)). The requirements are*

- *At least one of the licensed body's managers must be a person (other than a licensed body) who is an authorised person in relation to a licensed activity;*
- *No manager of the licensed body may be a person who is disqualified from acting as a manager of a licensed body.*

#### **Guidance:**

73. LAs must set out the details of how they comply with this requirement.

#### **Requirement:**

*Licensing rules may make further provision as to:*

- *the managers of licensed bodies; and*
- *the arrangements for the management by them of the licensed body and its activities (Sch. 11, paragraph 10(1))*

#### **Guidance:**

74. If LAs make licensing rules about these issues that differ from the equivalent provisions in non-ABS they should provide objective justification for any difference.

75. It may be that a LA considers that it is only competent to regulate entities with demonstrably similar risk profiles to those it already regulates as an AR. If a LA proposes licensing rules that place restrictions on the types of managers or the management arrangements that can be regulated by it, the LA must provide objective justification for the requirements. In these circumstances we would not normally approve the LA's licensing rules unless the relevant AR's regulatory arrangements had been changed so that they did not restrict an individual regulated by it (as an AR) from working in an ABS that was regulated by another LA with a wider range of competencies.

**Requirement:**

*Licensing rules must not require all managers of a licensed body to be authorised persons in relation to a reserved legal activity (Sch. 11, paragraph 10(2))*

**Guidance:**

76. LAs must set out the details of how they comply with this requirement.

**Head of Legal Practice (HoLP)**

**Requirement:**

*Licensing rules must include the requirements set out in Schedule 11, paragraph 11 (Sch. 11, paragraph 11(1))*

**Guidance:**

77. LAs must set out the details of how they comply with this requirement.

**Requirement:**

*Licensing rules must make provision:*

- *about the procedures and criteria that will be applied by the Licensing Authority when determining under Schedule 11, paragraph 11(4) whether an individual is a fit a proper person;*
- *for a review by the Licensing Authority of a determination under Schedule 11, paragraph 11(4) that an individual is not a fit and proper person;*
- *about the procedures and criteria that will be applied by the Licensing Authority under Schedule 11, paragraph 11(6) whether to withdraw its approval;*
- *for a review by the Licensing Authority of a determination under Schedule 11, paragraph 11(6) to withdraw its approval;*
- *about the procedure which is to apply where a licensed body ceases to comply with the requirement imposed by virtue of Schedule 11, paragraph 11(2).*

*Rules made may in particular provide that the requirement imposed by virtue of Schedule 11, paragraph 11(2) is suspended until such time as may be specified by the Licensing Authority if the licensed body complies with such other requirements as may be specified in the rules (Sch. 11, paragraphs 12(1) and (2))*

**Guidance:**

**Fit and proper test**

78. The LSB considers that it is appropriate for the fit and proper test for the HoLP to be the same as the test for external owners and to require the full disclosure of:

- any criminal charges or convictions (including spent convictions and cautions) or cases pending in the UK or elsewhere;
  - any previous disciplinary action taken by a professional or regulatory body in the UK or elsewhere, whether concluded or not;
  - whether the person has ever been disqualified as a director;
  - whether the person has ever been declared bankrupt (and whether or not this has been discharged) or entered into an Individual Voluntary Arrangement; and
  - any other material information that could reasonably be expected to have a bearing on their fitness to be a HoLP
79. We consider it reasonable for a LA to verify the information given if they can, and to consider refusing to grant a licence if false, misleading or insufficient information is provided. Although the LSB does not consider it appropriate for a HoLP to have a different test than an owner of the ABS, it may be that, in a LA's judgement, even if the information about the HoLP and the owner is the same, it may be acceptable for a person to be an owner of an ABS but not to be a HoLP. We expect LAs to provide guidance on the types of issues that may mean that someone is not fit and proper.
80. We do not consider that it is proportionate for there to be a requirement for these tests to be renewed on an annual basis. That is likely to lead to a significant regulatory burden with little prospect of significant identification of people in the roles who are not fit and proper. We anticipate that for good commercial reasons, ABS will ensure that strong governance will provide the means by which potential problems with the fitness of the HoLP are identified and dealt with. LAs may consider that there should be a requirement to notify them of any potential or actual changes as they arise and/or if the HoLP changes. However, this does not preclude LAs from requiring the provision of information on an annual basis, providing this is no more onerous than the equivalent requirements for non-ABS entities.
81. We consider that the qualifications and experience of the HoLP are, broadly, matters for the ABS to decide. It may, however, be appropriate to have a requirement for targeted continuing professional training for the role.
82. Unless they are demonstrably inappropriate to fulfil their role, we would not expect a LA to decline to approve an application for a HoLP. However, the information about the HoLP's qualifications and experience should be used to inform the LA's risk assessment of the ABS in order to target their monitoring and enforcement proportionately. We expect LAs to provide guidance on these issues, including the way in which they will approach their risk assessment. We consider that it is appropriate for that risk assessment process to take into account the competence and credibility of the HoLP in understanding the ABS

business and the regulatory requirements. It may be appropriate in some circumstances for the LA to interview the HoLP as part of their designation.

83. In order to encourage a culture of compliance, the LSB anticipates that LAs will want to give guidance on the appropriate level of seniority for a HoLP and who they report to, taking into account the size of the ABS. We would consider it appropriate to have a requirement for the HoLP to report to the most senior level of management (in a corporate ABS, the board of directors/members) or for they themselves to be a member of the most senior level of management. However, they must have the freedom to dissent from collective responsibility when reporting on matters to the LA. In either case, we would expect there to be a requirement for their roles and responsibilities within a firm to be clearly defined, although not necessarily by reference to a single model.

### **Reviews**

84. We expect LAs to have a comprehensive and quick internal review system to consider requests for review of a decision to decline to approve or withdraw approval of the HoLP. Such a review should be conducted by a person or people who have not been involved in the decision itself. The process must be set out in the LA's licensing rules. It is for the LA to consider how far it should involve a review of the legal adequacy of the process undertaken or should constitute a re-assessment of the application. Appeals to the appellate body would only be allowed from those who have exhausted their options for internal resolution by the LA, or when the LA has failed to complete a review within its own timescales. Other things being equal, a LA should not use the decision against an individual nominated for the role as a reason to deny a licence subsequently if a more satisfactory individual is identified.

### **Suspension of requirement to have a HoLP**

85. We expect that, in order to avoid a situation when the ABS would otherwise be unavoidably in breach of the Act, that licensing rules will set out a process for notifying the LA that there is no longer a HoLP and describe the possible approaches that the LA might take in such circumstances, including the maximum time before an interim arrangement is put in place and the maximum time for which any alternative arrangement can be in place.

### **Head of Finance and Administration (HoFA)**

#### **Requirement:**

*Licensing rules must include the requirements set out in Schedule 11, paragraph 13 (Sch. 11, paragraph 13(1))*

#### **Guidance:**

86. LAs must set out the details of how they comply with this requirement.

**Requirement:**

*Licensing rules must make provision:*

- *about the procedures and criteria that will be applied by the Licensing Authority when determining under Schedule 11, paragraph 13(4) whether an individual is a fit and proper person;*
- *for a review by the Licensing Authority of a determination under Schedule 11, paragraph 13(4) that an individual is not a fit and proper person;*
- *about the procedures and criteria that will be applied by the Licensing Authority in determining under Schedule 11, paragraph 13(6) whether to withdraw its approval;*
- *for a review by the Licensing Authority of a determination under Schedule 11, paragraph 13(6) to withdraw its approval;*
- *about the procedure which is to apply where a licensed body ceases to comply with the requirement imposed by virtue of Schedule 11, paragraph 13(2).*

*Rules made may in particular provide that the requirement imposed by virtue of Schedule 11, paragraph 13(2) is suspended until such time as may be specified by the Licensing Authority if the licensed body complies with such other requirements as may be specified in the rules (Sch. 11, paragraph 14(1))*

**Guidance:**

87. The equivalent guidance applies as for the HoLP above.

## **PRACTICE REQUIREMENTS**

### **Practising address**

**Requirement:**

*Licensing rules must require a licensed body at all times to have a practising address in England and Wales. [This] does not apply to a licensed body:*

- *which is a company or limited liability partnership; and*
- *the registered office of which is situated in England and Wales (or in Wales) (Sch. 11, paragraph 15(1))*

**Guidance:**

88. LAs must set out the details of how they comply with this requirement.

### **Licensed activities**

**Requirement:**

*Licensing rules must provide that a licensed body may carry on a licensed activity only through a person who is entitled to carry on the activity (Sch. 11, paragraph 16)*

**Guidance:**

89. LAs must set out the details of how they comply with this requirement.

**Compliance with regulatory arrangements etc**

**Requirement:**

*Licensing rules must include the requirements set out in Schedule 11, paragraph 17 (Sch. 11, paragraph 17(1))*

**Guidance:**

90. There are many different models of good governance and the LSB considers that it is a commercial decision for the ABS to decide what its overarching compliance policies should be in order to ensure a culture that promotes ethical practice and compliance with licensing rules. However we anticipate that LAs will want to set out their expectations of:

- a. good governance and strong operating procedures to ensure compliance with licence conditions; and
- b. identification by the ABS of risks, in particular to consumers, of its activities.

91. The aim should be to ensure that lawyers' duty to comply with their professional principles is not compromised by external owners or non-authorised persons and that consumers are properly protected and receive good quality legal advice.

**Disqualified employees**

**Requirement:**

*Licensing rules must include the requirement that a licensed body may not employ a person who under Part 3 of Schedule 11 is disqualified from being an employee of a licensed body (Sch. 11, paragraphs 18(1) and (2))*

**Guidance:**

92. LAs must set out the details of how they comply with this requirement.

**Indemnification arrangements and compensation arrangements**

**Requirement:**

*For the purpose of giving effect to indemnification arrangements and compensation arrangements, 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 (Sch. 11, paragraph 19(1))*

**Guidance:**

93. The LA should explain how its licensing rules on this issue interact with its rules on indemnification and compensation arrangements. In particular, LAs should note that the definition of “authorised insurer” (section 64(5)) is wide and does not require the use of a pre-approved insurer.
94. We expect LAs to provide evidence that shows that these arrangements remove where possible structural barriers to normal commercial activities such as issuing shares and share options, restructuring, mergers, acquisitions, closures and successor practices. Any remaining barriers must be objectively justified.

**Accounts**

**Requirement:**

*The licensing rules must make provision:*

- *as to the treatment of money (including money held on trust) which is received, held or dealt with by the Licensed Body, its managers and employees for clients or other persons; and*
- *the keeping of accounts in respect of such money (Sch. 11, paragraph 20(1))*

**Guidance:**

95. LAs must set out the details of how they comply with this requirement. We would expect the requirements to be the same as those for non-ABS carrying out the same reserved legal activities and/or holding client money.

## REGULATION

**Fees**

**Requirement:**

*The licensing rules must require licensed bodies to pay periodical fees to the Licensing Authority. The rules may provide for the payment of different fees by different descriptions of Licensed Body (Sch. 11, paragraph 21)*

**Guidance:**

96. LAs must have regard to the regulations to be made pursuant to the Framework Services Directive<sup>2</sup> which seek to ensure transparency of cost when licensing. We expect annual fees to be broadly cost-reflective and to allow for different

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<sup>2</sup> [http://www.opsi.gov.uk/si/si2009/plain/uksi\\_20092999\\_en](http://www.opsi.gov.uk/si/si2009/plain/uksi_20092999_en)

annual licence fees for different types of ABS. We also recognise that, in some circumstances, foreign ownership may result in a higher risk profile and/or greater investigation costs, which should be reflected in a differential annual licence fee.

## **Financial penalties**

### **Requirement:**

*The licensing rules must make provision as to:*

- *the acts and omissions in respect of which the Licensing Authority may impose a penalty under Section 95;*
- *the criteria and procedure to be applied by the Licensing Authority in determining whether to impose a penalty under that section, and the amount of any penalty (Sch.11, paragraph 22)*

### **Guidance:**

97. Financial penalties are likely to be used when, in the LA's judgement, it is appropriate to attempt to change the behaviour of the licensed body or an employee or manager, and to deter future non-compliance. We expect LAs' licensing rules to set out the criteria it will apply in deciding whether to impose a penalty and the factors it is likely to take into consideration when deciding the appropriate level of any penalty (up to the maximum level in the LSB's rules as consented to by the Lord Chancellor). There is a requirement for the LA to act proportionately to the circumstances of the particular case. It is important that LAs retain maximum flexibility to decide whether to impose a penalty on an individual or an entity or both, and the amount of the penalty. We do not consider it reasonable for a LA to set out indicative penalties in its licensing rules since this can distort behaviours and provide an incentive to "game" the compliance regime.
98. We expect the LAs to take into account the LSB's own enforcement process and best practice by regulators generally, including the Code of Practice for Regulators. If the LA is investigating a number of breaches as separate investigations, it may be appropriate for each investigation to impose a separate penalty, in each case.
99. We expect a LA's provisions (if any) for making oral and/or written representations prior to a final decision to impose a financial penalty to be consistent with those of non-ABS.

## Disqualifications

### **Requirement:**

*Licensing rules must make provision as to the criteria and procedure to be applied by the Licensing Authority in determining whether a person should be disqualified under Section 99 (Sch. 11, paragraph 23(1))*

### **Guidance:**

100. LAs must set out the details of how they comply with this requirement. In particular they should explain how this power fits within its overall approach to compliance and enforcement.

### **Requirement:**

*Licensing rules must make provision:*

- *for a review by the Licensing Authority of a determination by the Licensing Authority that a person should be disqualified;*
- *as to the criteria and procedure to be applied by the licensing authority in determining whether a person's disqualification should cease to be in force; and*
- *requiring the Licensing Authority to notify the Board of any determination by the Licensing Authority that a person should be disqualified, of the result of any review of that determination, and of any decision by the Licensing Authority that a person's disqualification should cease to be in force (Sch. 11, paragraph 23(2))*

### **Guidance:**

101. Every licensing authority must have a published, comprehensive and quick internal review system to consider representations against a decision to disqualify a person. Such a review should be conducted by a person or people who have not been involved in considering the disqualification itself. The process must be set out in the LA's licensing rules and it is for the LA to consider how far the process should involve a review of the legal adequacy of the process undertaken or should constitute a re-assessment. The appellate body will only hear appeals from those who have exhausted their options for internal resolution by the LA, or when the LA has failed to complete a review within its own timescales.

## Suspension or revocation of licence under section 101

### **Requirement:**

*Licensing Rules must make provision for the items set out in Schedule 11, paragraph. 24 (Sch. 11, paragraph 24(1))*

**Guidance:**

102. We expect licensing rules to set out the approach that the LA will take in the events specified. They should also explain how (if at all) it interacts with their powers to intervene in the running of an ABS. Customer protection issues such as transfer of files, client money and indemnity/compensation should be included.

**Requirement:**

*Licensing rules may make provision about other circumstances in which the Licensing Authority may exercise its powers under Section 101 to suspend or revoke a licence (Sch. 11, paragraph 25)*

**Guidance:**

103. In setting out their approach to this requirement, LAs should include the approach they would take if an ABS asked for its licence to be revoked.

**Requirement:**

*Licensing rules must make provision about the criteria and procedure the Licensing Authority will apply in deciding whether to suspend or revoke a licence, or to end the suspension of a licence, under Section 101 (Sch. 11, paragraph 26(1))*

**Guidance:**

104. LAs must set out the details of how they comply with this requirement.

**Requirement:**

*Licensing rules must make provision for a review by the Licensing Authority of a decision by the Licensing Authority to suspend or revoke a licence (Sch. 11, paragraph 26(2))*

**Guidance:**

105. Every licensing authority must have a published, comprehensive and quick internal review system to consider representations against a decision to suspend or revoke a licence. Such a review should be conducted by a person or people who have not been involved in considering the application itself. The process must be set out in the LA's licensing rules and it is for the LA to consider how far the process should involve a review of the legal adequacy of the process undertaken or should constitute a re-assessment of the case. The appellate body will only hear appeals from those who have exhausted their options for internal resolution by the LA, or when the LA has failed to complete a review within its own timescales.

## **Schedule 13 – Ownership of Licensed Bodies**

106. In principle (subject to the competence of the LA to regulate them), we consider that there should not be restrictions on the extent to which non-lawyers should be allowed to own law firms. The implementation of the safeguards in the Act

should help to detect undesirable owners, whether they are lawyers or non-lawyers.

107. We expect LAs to implement the ownership tests required by the Act in a proportionate way to ensure that they do not unduly restrict different types of ABS ownership. We consider that the requirements set out in the Act are designed to ensure that, as far as possible, people with improper significant influence are detected. However, LAs should bear in mind that the need for good governance and transparency of ownership are at least as important in helping to ensure a proper level of consumer protection.
108. LAs should pay particular attention to how an ABS will ensure that owners, managers and employees understand the regulatory duties that apply to its commercial activity by virtue of being a regulated legal services provider and that a duty to a shareholder or other stakeholder does not compromise the duties owed to the court and to the client.
109. We consider that the Act (in particular section 90 and section 176) gives a statutory basis to the duties that lawyers have to their clients and to the court, whoever the owner of the entity is. Taken together with the LA's enforcement powers and the divestiture provisions we do not consider that it will be necessary in most cases to impose additional requirements on an ABS. It may however be appropriate for a LA, in the particular circumstances of a licence applicant, to require additional safeguards in relation to ownership or influence. We would expect any such requirement to be objectively justified, with a right to appeal against it.
110. In general, we consider that licensing rules should require the disclosure by the licence applicant (with sufficient evidence to enable the LA to form a view) about who the ultimate beneficial owners of an ABS are and that this information should be made public. It may be that some limited exceptions to public disclosure are necessary and LAs should ensure they have the flexibility to use their judgment about when this is appropriate. However, we consider that the identity of the owner must always be disclosed to the LA.

## **The approval requirements**

### ***Requirement:***

*For the purposes of this Schedule, the approval requirements are met in relation to a person's holding of a restricted interest if:*

- (a) the person's holding of that interest does not compromise the regulatory objectives (the "regulatory objectives test")*

*(b) the person's holding of that interest does not compromise compliance with the duties imposed by section 176 by the licensed body or [any employee or manager of the licensed body who is an authorised person in relation to an activity which is a reserved legal activity], (the "regulated person's duties test") and*

*(c) the person is otherwise a fit and proper person to hold that interest (the "fitness to own test").*

*(3) In determining whether it is satisfied of the matters mentioned in subparagraph (1)(a) to (c), the licensing authority must in particular have regard to:*

*(a) the person's probity and financial position,*

*(b) whether the person is disqualified as mentioned in section 100(1), or included in the list kept by the Board under paragraph 51,*

*(c) the person's associates, and*

*(d) any other matter which may be specified in licensing rules.*

*(4) Licensing rules must make provision about the procedures that will be applied by the licensing authority when determining whether it is satisfied of the matters mentioned in sub-paragraph (1)(a) to (c).*

### **Guidance:**

#### **The regulatory objectives test**

111. As part of its licence application, an ABS must identify in its application any non-authorised person who is subject to the fitness to own test. LAs must require those applying for a licence to identify any issues that they consider may compromise the regulatory objectives. This should include identification of anyone holding a material interest that is subject to other duties which may conflict with the regulatory objectives and the steps they have taken to avoid creating a material conflict of interest. We do not consider that it would be appropriate to seek to assess whether an ABS will *enhance* any of the objectives, although an individual firm may want to present information on this issue. LAs may wish to include guidance about the type of matters that they consider may compromise the regulatory objectives.

#### **The regulated persons' duties test**

112. LAs should require information about how the ABS will ensure that its managers and employees are protected from any external owner or non-lawyer who might try to influence them improperly in order to compromise their independence or their adherence to professional principles or licensing rules. If that happens then the LA can use its enforcement powers including those of divestiture. The Act includes in the HoLP's duties a requirement to report any failure to comply with these duties to the LA. LAs should ensure that they have

an appropriately senior person in their own organisation that the HoLP can contact.

### **Fitness to own test**

113. Licence applicants must identify the people or entities that are subject to the fitness to own test and state the type of restricted interest they hold. We consider it reasonable for a LA to verify the information given (if they can). LAs should therefore require agreement from applicants that all the information provided can be checked with other bodies. They should have formal information sharing powers between themselves and other professional bodies and regulators about disqualified people and disciplinary action.
114. LAs licensing rules must explain their approach to assessing the outcomes of these checks and how they will be taken into account in making a decision whether to grant a licence. It is reasonable for a LA to consider refusing to grant a licence if false, incomplete or misleading information is provided. The LSB considers that it is appropriate for the fit and proper test for external owners (both lawyers and non-lawyers) to be the same as the test as for the HoLP and HoFA and to require the full disclosure of:
- any criminal charges or convictions (including spent convictions and cautions) or cases pending in the UK or elsewhere;
  - any previous disciplinary action taken by a professional or regulatory body in the UK or elsewhere, whether concluded or not;
  - whether the person has ever been disqualified as a director;
  - whether the person has ever been declared bankrupt (and whether or not this has been discharged) or entered into an Individual Voluntary Arrangement; and
  - any other material information that could reasonably be expected to have a bearing on their fitness to be an owner of a licensed body
115. We would consider it reasonable for LAs to require disclosure of disqualification from, for example, ABS and non-ABS, and to provide information about other companies that would be caught by any aspect of the test if it was applied to them.
116. We consider it reasonable for a LA to verify the information given if they can, and to consider refusing to grant a licence if false, misleading or insufficient information is provided. Although the LSB does not consider it appropriate for an owner to have a different test than the HoLP/HoFA, it may be that, in a LA's judgement, even if the information about the HoLP/HoFA and the owner is the same, it may be acceptable for a person to be an owner of an ABS but not to be a HoLP/HoFA. We expect LAs to provide guidance on the types of issues that may mean that someone is not a fit and proper owner.

117. LAs must explain how, in considering any adverse information from this test, they will assess it against the individual's role in the ABS. We consider that LAs should have the flexibility to disregard, for example, minor convictions. In other cases, licence conditions rather than disqualification may be appropriate.
118. We do not consider that it is proportionate for there to be a requirement for these tests to be renewed on an annual basis. That is likely to lead to a significant regulatory burden with little prospect of significant identification of people in the roles who are not fit and proper. We anticipate that for good commercial reasons, ABS will ensure that strong governance will provide the means by which potential problems with the fitness of the owner are identified and dealt with. LAs may consider that there should be a requirement to notify them of any potential or actual problems as they arise and/or if the owner changes. However, this does not preclude LAs from requiring the provision of information on an annual basis, providing this is no more onerous than the equivalent requirements for non-ABS entities.

### **Definition of material interest**

119. The Act gives a LA the ability to decrease the percentage at which an interest becomes material to less than 10%. The definition of a person holding a 'material interest' already includes eight categories of material interest and is already very wide in its scope. We would not, therefore, consider it appropriate for licensing rules to define 'material interest' at a percentage less than 10% unless a LA can provide an objectively justifiable reason (with appropriate evidence) for doing so.

### **Approach to Associates**

120. Consistent with the principles of better regulation, we consider that LAs should take a proportionate approach to their consideration of external ownership. In particular, they should avoid introducing overly prescriptive and burdensome checks on relationships that are likely to be de minimis or irrelevant in terms of any ability to influence improperly an ABS.
121. We consider it appropriate for them to have regard to tests used in other regulatory regimes, in particular in financial services regulation including the protection provided by the 3% disclosure threshold in company law and the requirements of codes concerning takeovers and mergers.
122. LAs must ensure that they have the capability to react rapidly if they acquire information suggesting improper influence and to introduce supplementary requirements for an ABS that they identify to be higher risk.
123. Although the LSB has not made rules about the prescribed periods in Schedule 13, we expect licensing rules to set out those periods and for them to be appropriate to enable there to be clarity about ownership as soon as possible.

### **Power to impose share limit, voting limit etc Requirement:**

*Licensing rules may provide that:*

*(a) a non-authorized person may not have a shareholding in a licensed body, or in a parent undertaking of a licensed body, which exceeds a limit specified in the rules (“the share limit”);*

*(b) a non-authorized person may not have an entitlement to exercise, or control the exercise of, voting rights in a licensable body, or a parent undertaking of a licensable body, which exceeds a limit specified in the rules (“the voting limit”);*

*(c) the total proportion of shares in a licensed body, or a parent undertaking of a licensed body, held by non-authorized persons may not exceed a limit specified in the rules;*

*(d) the total proportion of voting rights in a licensed body, or a parent undertaking of a licensed body, which non-authorized persons are entitled to exercise or control the exercise of, may not exceed a limit specified in the rules.*

*(2) Rules made under any paragraph of sub-paragraph (1) in relation to a licensed body and a parent undertaking may specify different limits in relation to the licensed body and the parent undertaking.*

*(3) Licensing rules made under sub-paragraph (1)(a) or (b) may provide that references in those rules to a person, in relation to a person’s shareholding or entitlement to exercise or control the exercise of voting rights, are to*

*(a) the person,*

*(b) any of the person’s associates, or*

*(c) the person and any of the person’s associates taken together.*

*(Schedule 1, paragraph 38)*

### **Guidance:**

124. We consider that LAs’ enforcement policies should ensure that ownership of ABS (whether by lawyers or non-lawyers) is properly regulated. We consider that any limits on shares or voting is therefore a commercial one for the ABS and do not consider that there should be any limit imposed by the LA, nor any other similar restriction (e.g. on sharing profits). For similar reasons, we do not consider that licensing rules should prohibit flotation of licensed bodies on a recognised investment exchange.

125. If a LA proposes (for whatever reason) to place restrictions of this nature on an ABS then this must be fully explained and justified. We would expect this to include evidence that there is an additional risk by non-authorized persons that cannot be mitigated by the fit to own test and how their proposed restriction

does mitigate it. We will also expect the LA to provide an analysis of the impact of the proposed restriction on competition. In these circumstances we would not normally approve the LA's licensing rules unless the relevant AR's regulatory arrangements had been changed so that they did not restrict an individual regulated by it (as an AR) from working in an ABS that was regulated by another LA with a wider range of competencies.

### **Continuing notification requirements (Schedule 13 paragraph 21)**

126. It is likely that the liquidity of shares will be affected by the requirements in the Act to notify a LA of a proposal to acquire an interest or option in an interest *before* the acquisition itself. The Act requires that a licensed body and LA must be notified whenever an investor 'proposes to take a step' which results in acquiring a restricted interest. We recognise that in certain circumstances the liquidity of the shares may be particularly important and may be materially affected by this requirement.
127. In order to seek to minimise the impact of this requirement on commercial decisions and the liquidity of shares we consider it would be appropriate for there to be a licence condition for floated ABS that gave all new shareholders of a notifiable interest conditional approval for a set period during which time they would have to pass the relevant fitness tests. LAs may also consider it appropriate to have a "pre-approval" process for these circumstances.

### **Foreign ownership**

128. As a principle we would not expect foreign ownership of law firms to be restricted, but recognise that special conditions may need apply where the owner may benefit from legal immunity (e.g. in a sovereign wealth fund context). We also recognise that, in some circumstances, foreign ownership may result in a higher risk profile and/or greater investigation costs, which we believe should be reflected in a differential broadly cost-reflective application fee and in the broadly cost-reflective annual licence fee. The proposed requirement that all ultimate beneficial owners must be declared and that the information must be made public may also help to identify any specific risks. The LSB believes that this is proportionate, and that it is not appropriate to ban certain categories of foreign ownership of ABS.

## **OTHER PROVISIONS**

### **Appellate body**

129. Licensing rules must specify one body to which appeals can be made for those issues for which the rules (and/or the Act) provide a right of appeal. The rules must explain how the applicant has ensured that the appellate body has the competence to deal with the range of appeals that may be made to it. The rules

themselves must make clear what (in addition to Act's requirements) can be appealed. An applicant must provide evidence from the appellate body that it consents to the designation.

130. The LSB will publish further guidance on this issue following discussion with relevant parties.

### **Legal Disciplinary Partnerships (LDPs) and Recognised Bodies**

131. We expect LAs' licensing rules to enable entities (excluding special bodies) that are covered by the Act's transitional arrangements to apply for licences before the end of the transitional period (which will be 12 months after the introduction of ABS).

### **Capital adequacy**

132. Licensing rules should not seek to restrict business models unless there is clear evidence of consumer detriment. We do not, therefore, consider that it is appropriate for there to be a capital adequacy test for ABS. Rather, information about an ABS finances should be used to inform a LA's risk assessment of the entity and to ensure that they have effective processes in place to deal with a failing entity.

### **Reserved and unreserved legal activities**

133. LA's approach to deciding whether they should regulate reserved and/or unreserved legal activities should reflect the current levels of consumer protection. So activities that are currently reserved (or unreserved) will remain reserved (or unreserved). If unreserved activities are currently (or in future become) regulated by an AR then they should also be regulated by the relevant LA. We expect rules to indicate the types of issues that a LA will take into account when making conditions as to the non-reserved activities which the ABS may or may not carry on (section 85(7)).

### **LA competence**

134. We recognise that there may be some LAs that will not be competent to regulate all types of ABS, in particular those with complex structures (whether external or lawyer only). A Licensing Authority's licensing rules should set out the type of ABS that can apply to it for a licence. If this places restrictions on the extent or nature of external ownership then this must be fully explained and justified. In these circumstances we would not normally approve the LA's licensing rules unless the relevant AR's regulatory arrangements were also changed so that they did not restrict an individual regulated by it (as an AR) from working in an ABS that was regulated by another LA with a wider range of competencies.