Regulating Alternative Business Structures

Report on responses

November 2009

Introduction

1. The SRA discussion paper "Regulating Alternative Business Structures", was published in June 2009 with a closing date for responses of 31 August 2009. A total of 33 responses have been received: nine (27%) of which were from regulatory bodies, ten (30%) representative bodies of solicitors and other involved in the provision of legal services; four (12%) firms of solicitors; and nine (27%) other bodies, of which three (9%) stated that they intended to establish an ABS. Approximately fifty per cent of the responses were from members of the profession or those representing the profession. We have also drawn on the responses of Which? and Consumer Focus to the LSB consultation. We consider that we have received a sufficiently broad range of views to reach some conclusions on the way forward. A full list of the respondents, is given in Appendix 1. The Law Society response is attached at Appendix 2.

2. We thank all respondents for taking the time to prepare considered responses which have helped to confirm some guiding principles and offered guidance on difficult and complex issues.

3. Responses were varied and often discursive in their nature, following the nature of the paper which deliberately did not seek simple "Yes/no" answers. This paper therefore, expresses our interpretation of the responses and this should be taken into account in relation to the statistics provided for those expressing support or opposition to our proposals. We have concentrated on the qualitative content of responses in reaching any conclusions and not simply on a statistical analysis.

4. The two key principles underlining the SRA's position set out in the consultation paper were that:

- Consumers should have the benefit of the same standard of protection whether receiving services from traditional law firms or ABS. This does not mean to say that the rules or approaches to regulation will be the same as now; a review will be necessary. What it would mean is that broadly the same regime would apply to all types of firm.

- Restrictions on ownership and control should be removed in line with the requirements and safeguards set out in the LSA, without adding unnecessarily to the minimum requirements.

5. The reasons why the SRA considers that the approach described in the first principle above makes good sense are that:

   - For consumers, they can be assured of the same levels of protection provided by all firms "regulated by the SRA".

   - For the regulated community, there will be no competitive advantage to any model,

   - In terms of cost, the SRA would be able to deliver effective and cost efficient regulation for all firms.

   - For the many traditional law firms who will become an ABS in order to take advantage of the new forms of investment and for LDPs, the transition to become an ABS will be at limited cost.

   - For new entrants, the regulatory regime will be familiar to the authorised persons they will employ to supervise and deliver legal services, and there will be clarity in their obligations, assisting set-up.

   - For the public, assurance that the regulatory objectives and the professional principles are maintained during a time in which the delivery of legal services will change significantly.

Overview

6. The objective of the SRA's paper was to set out its initial views on how it should regulate ABS seeking views on the broad direction of travel. The paper also raised a number of more specific issues which needed further consideration – inviting initial views. As the more detailed analysis below shows there is a broad consensus among the majority of respondents for the direction of travel and on the identification of issues for further consideration.

7. In summary, respondents expressed:

   a) Support for progressing with the introduction of ABS to the LSB's timetable. However, respondents expressed an overriding need to ensure that clients' interests were adequately protected through the implementation.

   b) The need to ensure a level playing field in terms of:

i) The level of protection provided to clients of all types of firm.

ii) The regulatory requirements imposed on all types of firm, except where the risks posed by an particular type of firm clearly justified imposing a more stringent requirement;

c) Agreement with the ABS models identified. Only one respondent identified an additional model. However, most respondents recognised that it was difficult to foresee all potential models at this stage and agreed that the regulatory framework should not be limited to particular models.

d) Concern regarding the specific risks posed by ABS. Some respondents felt that these risks had not yet been fully investigated and that more work needed to be done in this area before finally determining whether additional requirements should be imposed on ABS and what these should be.

8. Following the consultation, it is clear that there remain some significant areas of uncertainty on which major work is required:

e) Multi-Disciplinary Practice ABS – the extent to which their services should be ring-fenced and how entity-based regulation should apply to such a business;

f) The definition of access to justice;

g) The practical application of reserved and non-reserved legal services and the manner in which each could be provided by ABS;

h) Insurance and compensation fund requirements for ABS – should these be more stringent for ABS and should ABS participate in the same compensation fund?;

i) The role of the HOLP and HOFA and requirements for each of these in terms of experience, qualifications, level of seniority within the firm, etc.

9. The paper analyses the responses received and sets out conclusions for the way forward on each issue.

Report on responses

Discussion points

10. Set out below is an analysis of responses to the Discussion Points raised on the broad direction of travel.

11. The SRA Board has considered the responses in detail and have adopted the conclusions set out in this paper to form a basis for the development of the regulatory regime for ABS, subject to any different requirements of the Legal Services Board.

Discussion point (i) ***Do you agree with our starting proposition – i.e. the proposed regulatory framework will not seek to add unnecessarily, if at all, to the minimum conditions required in the Act?***

12. It is probably not surprising that most respondents who responded to this question (20 out of 33) agreed with this proposition. However some, including Shelter, felt that the right test was not the minimum conditions required by the Act, but the minimum required for consumer protection. Other regulators, and the CML, considered that if risks are identified which would not be satisfactorily dealt with under the minimum conditions in the Act, then additional conditions or restrictions should be imposed.

13. Many respondents stressed the need to create a level playing field between firms of solicitors, LDPs and ABS both for consumers and providers. One respondent, the Institute of Chartered Accountants of England and Wales indicated that this may necessitate a review of the existing requirements imposed upon regulated firms:

> "The Institute is concerned that current regulatory arrangements will inevitably influence the formation and operation of ABS. This will encourage workaround arrangements and distort true competitive forces, contrary to the spirit of the Act."

Conclusion

14. The SRA should:

- confirm the principle that it will not seek to add unnecessarily, if at all, to the minimum conditions imposed in the Act;

- continue to investigate the risks associated with providing legal services in all types of firms, with a view to reducing/adding to its regulatory requirements, where justified in the interests of protecting clients.

Discussion point (ii) ***If not, please explain what additional restrictions you believe may be necessary to address what risks?***

15. Most of those who expressed some concern about the first proposition had few specific examples of additional restrictions that might be required. This is partly because some respondents felt that further investigations of the risks associated with the ABS models needed to be made, which in turn would enable the SRA to identify additional appropriate additional restrictions. The City of Westminster and Holborn Law Society stated that:

> ***"We consider that further information is needed, in particular from potential investors, other professionals and indemnity insurers to clarify what additional risks are likely to arise in each type of ABS."***

16. A number of respondents felt that there was a greater risk of an ABS collapsing than a traditional firm of solicitors, for example because of an owner's other business interests, or because of the strength of profit motive. Other respondents felt that the potential for complex business structures could both create additional risk and prevent the SRA from identifying and understanding the nature of those risks.

Conclusion

17. See the conclusion under Discussion point (i) above.

Discussion point (iii) ***Do you agree that we should try to provide a regulatory framework for ABS as soon as possible? Please give reasons for your answer.***

18. Of those that responded on this point, 14 out of 20 respondents agreed. The Law Society of Scotland recognised the many benefits that ABS could bring for firms and customers and stated that:

> ***"With these advantages in mind the Society agrees that a regulatory framework should be in place as soon as is reasonably possible to allow firms and consumers to avail of these new structures."***

19. Many agreed while also saying that it was important to get it right and that the need for speed should not lead to an ill thought out framework. For example:

- Shelter said that, ***"…it is crucial that the regulatory system for ABSs is developed appropriately and not implemented before it is ready, in particular in respect of special bodies given the wide discretion the regulator has to vary the requirements."***

- The Office of the Immigration Service Commissioner stated:

"The Commissioner considers that the SRA should certainly not delay in designing a framework for the regulation of ABSs or preparing for its implementation especially as the Legal Services Board (LSB) proposes to start issuing licences in mid-2011. However, the SRA must ensure that it takes sufficient time to think through the challenges posed by the regulation of ABSs and develop appropriate measures for dealing with them. The SRA should ensure that it takes into consideration any "lessons learned" from the introduction of LDP's. There is no merit in hastily assembling a framework that subsequently proves inadequate."

20. Six respondents felt more strongly that taking the time to get it right was more important than meeting the current target. The Bar Standards Board felt that more time should be allowed to understand the lessons learned from LDPs: ***"We recommend a step by step approach building on experience, rather than the big bang proposed by the LSB. More time is needed to learn lessons from LDPs before permitting other forms of ABSs."***

Conclusion

21. The SRA's view is that the lessons to be learned from the development of LDPs have relatively limited applicability to assessing the risks of ABSs, and the timetable should not be delayed. The SRA should proceed with the implementation of ABS to its planned timetable, whilst monitoring the risks (especially those identified by those representing vulnerable groups), and recognising that the timetable may be affected by the content of the guidance on licensing rules to be issued by the LSB.

Discussion point (iv) *Do you agree with the principle that the ABS regime should provide to the public the same consumer protections provided by the current regulatory framework?*

22. There was overwhelming agreement with this proposition: twenty four respondents broadly agreed and none disagreed. One respondent, Co-operative Legal Services, stated that, "CLS believes that the consumer protections should be exactly the same whether they be utilising the services of an ABS or private practice."

23. Some of the other regulators and the CML added that there may also be a need for additional consumer protections to deal with new or increased risks:

"We are concerned that the level of regulation as it currently stands has been insufficient to satisfactorily deal with [solicitor driven fraud]. Therefore, regulation in a light touch manner gives us great concern. Lenders have to have confidence in their legal services provider. The introduction of non-solicitors is of concern in itself and if this is to be introduced there has to be very strong regulation with stringent sanctions which would equally apply to the non-lawyers in an ABS."

24. The additional risks foreseen by some respondents related to the nature of the ABS and the potential for customers to misunderstand their structure and the type of services provided.

25. One respondent differentiated between consumer protections and the specific regulatory requirements currently in force for solicitors and LDPs: ***"We agree in principle that the consumer protections should be the same. However, there may be instances where regulatory requirements (such as the separate businesses rule)……are portrayed as elements of consumer protection. While our view is that consumer protection should be the same, it does not necessarily follow from this that the ABS framework should be designed to reflect the current rules applicable to regulated law firms."***

26. The Bar Standards Board agreed with this and cautioned that some existing requirements may negatively affect the introduction of ABS: potential form of ABS and their attractiveness or lack of attractiveness to certain businesses and professionals. ***"These are not "consumer protections" in the true sense of the word but are arrangements which have served their time and are anti competitive. To allow "the same" protections to continue when they are not true consumer protections will distort ABS implementation."***

27. Other responses were as follows:

> ***"As with traditional law firms, ABS should be required to comply with the appropriate arrangements for indemnity insurance and compensation arrangements. The level of consumer protection should be the same for ABS as for other comparable law firms."***
>
> The Law Society

> ***"Yes, of course, we believe the public should be given the same consumer protections provided by the current regulatory framework. The challenge, however, is in achieving that level of protection when we are talking about a business model which ranges across the entire spectrum of business from a one man band to a multi national conglomerate, and everything between."***
>
> Motor Accident Solicitors Society

> ***"At paragraph 2.10 the SRA proposes that the public are entitled to the same ethical standards and minimum standards of service from all providers of legal services. That is self-evident and supported by the Group but that means that the standards of the ABS should be as high as those of a traditional solicitors firm and the Group agrees that there should be no public policy requirement to reduce or remove the consumer protections provided to clients at the moment."***
>
> Solicitor Sole Practitioner Group

> ***"We believe that there should be one regulatory regime for those who provide reserved legal services."***
>
> Solicitors in Local Government

Conclusion

28. The SRA should

- Proceed on the basis that the consumer protections for ABS will not significantly differ from those currently imposed on firms of solicitors and LDPs, except in cases where the risks associated with ABS are demonstrably different/significantly higher than for other types of firm. We expect that such cases will be limited.

- Complete a review of the current rules to ensure they are "fit for purpose" for ABS and traditional law firms, removing unnecessary restrictions.

- Discuss with LSB whether and how a risk assessment could be taken forward to assess the risks posed by different types of firm to identify cases where a differentiated approach is justified.

Discussion point (v) *If you disagree, please give reasons explaining which consumer protections you consider necessary for ABS?*

29. This question should probably have asked what consumer protections were "unnecessary" for ABS and, perhaps unsurprisingly, there were no responses under this point which argued that any consumer protections were "unnecessary" or inapplicable to ABS, although later responses, for example on reserved/unreserved legal activities and the separate business rule, did go to this point, as acknowledged by respondent, who pointed out that their responses to Discussion points (iii), (viii) and (ix), and E, F, G, H, K, L and N in effect answered this question.

30. Again, a common point was that more must to be done to understand the risks associated with different types of ABS.

Conclusion

31. See conclusions under (iv) above.

Discussion point (vi) *Do you think there are other broad models than the three set out here?*

32. The majority of respondents agreed with the three broad models suggested and did not add other models. Many of the respondents highlighted the difficulty in trying to anticipate all possibilities (for example it is not easy to predict the nature and extent of overseas interest in ABSs) and therefore the need for flexibility in regulatory requirements to prevent stifling unanticipated models. Coupled with this was the concern that the SRA should retain the facility to restrict particular models that prove to be not in the interests of clients.

33. The Legal Services Policy Institute suggested that it would be better to look at models using a matrix distinguishing different models relating to services and ownership, as being more flexible and reflecting reality. That is a helpful method of analysis for the future.

34. The additional broad models suggested were as follows:

- A model with non-lawyer ownership but with ownership being (or including) internal rather than external owners, for example non-lawyer staff being offered shares, share options or other ownership interests in the ABS.
- Hybrids or combinations of the suggested models, for example private equity ownership of an MDP rather than a purely legal practice; or a mix of external and internal ownership in models 1 (LDP), 2 (External owners with no interest in the supply of legal services) and 3 (external owners with an interest in the supply of legal services).

Discussion point (vii) *Do you think there are other examples of models to be added to those in Appendix A?*

35. Again the majority had no comment or nothing further to add. However, the following additional suggestions or variations were suggested:

- An MDP dominated by non-legal professionals.
- A hub and spoke arrangement where different professional practices (e.g. legal, accountancy and IFA) establish a holding company to provide mutual support, overhead savings etc, in which each has an ownership interest and which owns the respective professional practices.
- A legal practice owned by an external owner which is a non-legal professional.

Conclusion

36. Continuing to identify different models is a useful exercise to help in testing the regulatory framework, but the framework should not be based on particular models.

Discussion point (viii) *Do you agree that the regulatory regime should focus on outcomes and supervision rather than attempting to restrict business models?*

37. There was broad agreement with this proposition (twenty one respondents broadly agreed with this proposition), although there were clearly differences of opinion about what was meant by “focusing on outcomes”, with some appearing to believe that such an approach was reactive. Outcomes based regulation and supervision were frequently linked to “principles-based” regulation. Although there was quite widespread support for principles-based

regulation, some respondents also expressed concerns about its effectiveness. Much depended on the respondent's interpretation of this concept, with some respondents seeming to view principles-based regulation as little more than a statement of principles, with no supporting rules. Others welcomed principles-based regulation but at the same time underlined the need for clarity of regulatory obligations. Examples of responses are:

> ***"In general, we agree with the principle that the regulatory model should focus on outcomes rather than attempting to restrict business models or indeed categorise them. However, we do consider that a key requirement will be to ensure that the ABS is ring-fenced from any other elements of the owner's business."*** The Law Society.
>
> ***"Regulating small entities by focussing upon outcomes may be appropriate where only a few consumers will suffer when things go wrong. We are concerned however that this form of regulation may not be appropriate for very large ABSs where large numbers of consumers could be affected adversely before the regulator is alerted to what is happening."*** Hertfordshire Law Society.
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> ***"Any regulatory regime introduced for ABS should adopt a proportionate response, with its focus on outcomes, monitoring and enforcement rather than detailed operational structures."*** Royal Institute of Chartered Surveyors.
>
> ***"As indicated above, we think it is right that the regulatory regime focuses upon outcomes and supervision rather than trying to restrict business models. It is important that in the shift from rules based to principles based regulation there is sufficient clarity as to what is meant by principles based regulation and the principles must be written in a clear and unambiguous fashion. We believe that the fundamental values and principles should apply regardless of the type of business model."*** Firm of solicitors.
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> ***"We support a regulatory approach based on high-level principles and outcomes, rather than one which sets out prescriptive rules."*** Consumer Focus response to the LSB's ABS Consultation Paper.
>
> ***"We would advise a cautious approach to principles-based regulation. We acknowledge the drawbacks of rules based regulation in that it can lead firms to seek to find ways round the rules. However, we have always maintained that our final verdict will depend on a clear improvement in consumer outcomes. Whilst, in theory a principles based approach can increase the responsiveness of regulation, there are a number of reasons why we are concerned."*** Which? response to the LSB's ABS Consultation Paper.

38. Respondents were reluctant to restrict business models. One firm, Addleshaw Goddard, saw some merit in the SRA specifically approving some structures:

> ***"We do, however, see some merit in the SRA producing a list of "safe harbour" structures. Not only would this give firms and investors some clear guidance as to the kind of schemes which are acceptable, it would also enable simple applications, which fall within the safe***

harbour categories to be fast-tracked through the licensing system, and we see a great deal of merit in this. It should be clear, however, that any such list is non-exhaustive."

39. Other respondents argued for structures to be reviewed on a case by case basis and/or that risks associated with particular business models were not yet fully known.

40. Shelter argued, "Whilst the primary focus should be as stated, the SRA should retain the facility to restrict particular business models should they prove inappropriate or not in the interests of clients. "

41. A few respondents expressed some concerns about particular business models that ought to be considered at the point of application for licence or subject to some restriction. For example, the City of Westminster and Holborn Law Society stated that:

"We largely agree that the focus should be on outcomes and supervision however we can see the possibility of practical difficulties with certain business models, particularly in relation to areas of practice where there may be inherent conflicts of interest and in respect of indemnity insurance."

42. This view was echoed by the Office of the Immigration Services Commissioner:

"The Commissioner considers that, generally the emphasis should be on ensuring the fitness of particular firms rather than restricting business models. However, she believes that it is just as important to have robust entry checks as in having effective supervision of licensed bodies. She also recognises that there may be a need to proscribe some models on the grounds that they involve an inherent level of risk which cannot be satisfactorily managed."

43. Examples given by the Commissioner are:

- ABSs in which non-lawyer owners or managers have a controlling interest; and
- combinations involving those types of organisation which have often used as fronts for the facilitation of immigrants (for example, Employment agencies and small charities (i.e., those with a turnover of less than 10k p.a.).

Conclusion

44. Work on the new approach to supervision referred to in the Consultation Paper should continue. However, the SRA should be willing to impose conditions on or refuse a licence of an ABS if the business model is considered particularly high risk to consumers. The SRA will develop the skills to make that assessment.

Discussion point (ix) ***Does this, (i.e. broadly the application of the current core requirements to ABSs, with new entity requirements (fitness to own test) and a developed risk based and outcome based regime) - seem the right approach to the prompt introduction of ABS?***

45. There was broad support for this approach **(nineteen** responses specifically agreed). Many respondents expressed the view that what would be most important was the establishment of a level playing field between traditional law firms and ABS.

46. In addition, two respondents made the point that firm-based regulation would be insufficient as a credible deterrent unless supported by the regulation of individuals.

47. Other respondents linked the approach to regulating firms to issues of cost. Will other firms in effect be paying for the cost of regulating ABS, given the potential disparity in size?

48. A small number of respondents stated that "risk-based" regulation required experienced staff in the SRA who were able to identify issues that gave rise to risks.

49. On the subject of the application of this approach to MDPs, respondents agreed that there may be jurisdictional issues if the MDP employed a variety of professionals. One respondent suggested that the firm, as a whole, might need to fall within one regulatory regime whilst being subject to other regulatory requirements.

50. One respondent explicitly disagreed with the proposed approach:

> ***"This may be the right approach to the prompt introduction of ABS. In our view it is not the correct approach to the introduction of ABS. The approach set out, and in particular the definition of "solicitor" services is unworkable. The first step which needs to be taken is to identify what services the SRA will regulate. It is not enough simply to state that the SRA will regulate services normally provided by a solicitor. This may cause potential conflict with other regulators – for example, in an ABS comprising accountants and solicitors providing tax advice, all services provided are of a type provided by both solicitors and accountants and may be subject to conflicting regulation."*** City of Westminster and Holborn Law Society

Conclusion

51. The SRA Board should:

- Adopt the approach suggested in the Consultation Paper.

- Hold discussions with LSB and other regulators in relation to MDPs, to assess how a services-based approach could be applied to such firms and how issues of regulatory conflict can be managed, and to minimise the cost (and have awareness) of dual regulation.

- Ensure that it develops the skills to assess new risks arising from the different models of ABSs.

Issues for further consideration

52. In the second part of the discussion paper the SRA set out a number of issues that need further consideration, giving an indicative early view as to what the SRA's approach might be, and seeking views.

Comments on issues for consideration

Issue A *Reserved/non-reserved legal activities*

53. Many respondents acknowledged that the issue discussed in this section was possibly one of the most difficult, and largely stems from the form of the legislation. The majority (14 out of the 18 who responded on this) support the proposition that in a ring-fenced ABS providing legal services then all services should be regulated. There were slightly different views on the question of whether an ABS should be able to hive off non-reserved legal work into a separate unregulated business while providing reserved legal work through the regulated body. Currently solicitors' firms are prevented from doing this by the separate business rule. Of those who gave views 9 (which included regulatory bodies, those representing solicitors' interests and both commercial and non-commercial non-solicitor organisations) considered that an ABS should not be able to separate non-reserved legal work into a separate unregulated business and 4 thought the opposite.

One solicitor's firm commented ***"Your suggestion looks to us to be regulatory land grab and the understandable restrictions placed upon solicitors acting in a professional capacity currently is and will be too restrictive in the world of ABSs to allow solicitors to compete effectively. We do not accept that the current separate business rule provides better protection for the consumer and we do believe that the whole rule should be reviewed and revised.***

The same applies to what are reserved and non-reserved activities. If it is felt that the public need further protection then the better way to do it is to extend the scope of reserved activities, which will then provide at least a level playing field for all organisations undertaking these types of activities".

Half of all respondents thought that which ever way forward was decided for ABS then the same should apply to traditional law firms in order to ensure a level playing field. The other half did not comment on this.

Some pointed out that a level playing field did not exist at present due to the unregulated sector of the legal services market. The Legal Services Policy Institute, for example, says ***"we would be concerned about the lack of a level playing field (1) if ABSs were allowed to hive off their non-reserved activities in ways that regulated law firms cannot, and (2) where ABSs and regulated law firms are at a competitive disadvantage as against unregulated entities delivering non-reserved services".***

Many respondents recognised that the issue discussed in this section was a key issue for the Legal Services Board and its Consumer Panel and this may indeed be the right way forward as there are clearly strong views on all sides.

54. On the question of reserved and non-reserved work, Shelter concluded that ***"a client would expect that if a body is regulated in the provision of legal services, it is regulated in the provision of all its legal services, and a distinction between reserved and non-reserved activities would be illogical and confusing".***

Conclusion

55. That the separate business rule should be reviewed but broadly maintained and applied to ABSs in relation to core legal services, to ensure consumer protection and a level playing field, subject to any detailed review by the LSB and its Consumer Panel.

Issue B *Is there anybody who is not able to be licensed or own an ABS?*

56. Of those who responded to this question, roughly two-thirds broadly supported the SRA's initial view that there are likely to be few, if any, types of organisation with interests so adverse to those of clients that they ought to be prevented from owning or investing in an ABS. For example, the CLLS thought that ***"it would not be desirable to stifle innovation by trying to formulate categories of businesses [which] should not be allowed to own an ABS".*** Some thought that the SRA should not rule out models which it could not at this stage predict, but should be prepared to refuse licences in relation to any application where it appears that the interests are such that the business model could not be successful without, in effect, the organisation having to breach rules.

57. One large firm argued that the approach should be to manage the risk posed by certain owners by, for example, restricting their participation in

management decisions, and imposing disclosure and consent requirements. Another drew a parallel between third party litigation funding and external ownership of an ABS, and suggested that the developing Civil Justice Rules might be useful in devising rules to minimise pressures on lawyers from non-lawyers owners.

58. Roughly a third of respondents to the question were more cautious about ownership. The Motor Accident Solicitors Society (MASS) favoured a more proscriptive approach. In the case of insurance companies, MASS argued, the conflict between the client and the organisation would be too great to resolve through conflict rules, and the regulator would not have sufficient resources to supervise or monitor the organisation. The City of Westminster and Holborn Law Society expressed similar reservations about insurance companies because of their role both as defendants and funders of litigation. It also queried whether a consumer association which set up a trading arm could thereafter represent itself as independent: ***"As soon as such groups begin providing services commercially, or on the basis of self-interest, there is a clear conflict of interest",*** such that the organisation ***"should not be able to have any part in a firm providing legal services".***

59. Other comments included the following:

- "The Institute does not believe that there should be general or generic prohibitions on ownership of ABSs. [However] … We would be concerned about any structure, business model or incentive which puts … a lawyer's personal, economic or commercial interest ahead of the professional principles or ran any actual or perceived risk of doing so." (LSPI)

- "Ensuring that owners are 'fit to own' will be key in mitigating the new risks posed by ABS." (TLS)

- "… there are industries that could be considered incompatible with the status of a legal profession or the core duties of lawyers, despite the individual investor being upright, honest and solvent or otherwise operating a business that complied with applicable laws. Consideration should be given to including a power to disqualify an investor on those grounds … ". (From a large firm)

Conclusion

60. The overall theme of the responses confirms the SRA's initial view that there should be no general prohibition on categories of owner or investor. No new risks appear to have been identified as requiring such a prohibition. The SRA remains of the view that those risks identified in the paper and the responses should be manageable through appropriate rules and other provisions, while reserving the ability to refuse a licence on the basis that the risk of inherent conflict is too great – on a case by case basis. The first step would be to see if risks can be mitigated by licence conditions.

Issue C *How will we take into account the object of improving access to justice?*

61. The SRA's initial view was that it would not be proportionate to impose a specific requirement on all new providers but perhaps to see whether certain applications could be subject to an objection process which may then require a market or economic analysis to be made. A small number of respondents (3) supported this general view, and a smaller number (2) opposed it. However many respondents, whilst not tackling the specific question posed, made very valuable contributions to the debate on this difficult issue.

62. Many pointed out that the term "access to justice" needs clearer definition, and is not necessarily the same as access to a range of legal services. Some want the LSB to take the lead on this.

63. Respondents also pointed out that access to justice is not just about geographical access, but also affordability, quality of service and the range of services on offer.

64. Some respondents stated that we need to consider access to justice as a wider issue, and not just in relation to applications for a licence; we need to make clear our regulatory objective in promoting this, undertake proactive monitoring and reserve powers to become involved should the market become distorted.

65. One solicitor's firm suggested a radical approach to meeting this regulatory objective which is the introduction of a compulsory "before the event" insurance policy to cover all forms of advice. Many respondents made the point that simply opening up the market to ABS would improve access to justice:

> ***"There are many parallels in society where the involvement of substantial organisations improves the quality of the offering for all parties involved and if anything they will address accessibility of location of individuals and ensure competitive pricing."***

66. The Law Society (and others) had particular concerns about the impact on access to justice particularly for vulnerable client groups needing particular types of service where accessibility in a particular geographical area would be important. However, the Law Society recognised that it may not be necessary to require an analysis in all cases and also recognised the cost of such an exercise.

67. The Association of Partnership Practitioners pointed out that access to justice is not perfect in the current market, and that ***"…we need to be certain that we are not trying to preserve in aspic some rose tinted view of the profession. Successive surveys by the Consumer Association suggest that many consumers are daunted by the possibility of seeing a solicitor and confused by the advice given"***.

68. The consumer organisation Which states in its response to the LSB's consultation that ***'We agree that it is likely to be only in very special circumstances that an ABS licence should be declined on the basis of the failure to meet the access to justice condition alone. Any such action would involve attempting to anticipate the impact on the market of the entry of a particular provider, an impossible task and one that is better left to competition authorities looking at the market as a whole as opposed to***

licensing bodies". However, improving access to justice is one of the regulatory objectives set out in the Legal Services Act for all legal regulators to meet. This difficult issue must still be tackled. In his recently published Review of the Regulation of Legal Services Lord Hunt makes the following recommendations (inter alia):

> ***"3. I recommend that the SRA should produce a clear statement of its policy towards encouraging competition in the field of legal services.***
>
> ***…***
>
> ***5. I recommend that the SRA should produce clear criteria against which it can assess and/or measure access to justice, and clear policies for ensuring that the regulatory regime in general embodies a commitment to wider and speedier access to justice."***

Conclusion

69. Discussions should be held with the LSB to clarify the definition of access to justice, and consider whether rules can require applicants to indicate how they promote access to justice, and whether reserve powers can be advised in areas where there is cause for concern.

Issue D *Equality and diversity within the legal profession*

70. Most who commented supported the need for an impact assessment. There was general support for the proposal that the current equality and diversity requirements of the SRA's Code of Conduct should be applied to ABSs. All respondents who answered this question in specific terms (8) agreed with our proposals.

71 A number of responses gave examples of where ABS could both provide positive benefits and increase equality and diversity, and where the Legal Services Act could act as a catalyst for change. Examples given include different ways of working which could result from a significant investment in technology, and different business models leading to better career options for those wishing to pursue a less traditional route into the law. The key concern was that the growth of ABSs might make it more difficult for small firms to operate and there may then be a disproportionate impact on BME solicitors. Others, however, commented that new ways of working for example through franchising or hub and spoke arrangements could continue to support BME solicitors operating in small organisations.

Conclusion

72. The SRA should:

- Apply the current equality and diversity requirements, set out in the Solicitors' Code of Conduct 2007, to ABSs;
- Monitor levels of compliance,

- Monitor the impact of ABSs on the provision of legal for equality and diversity consequences.

Issue E *The fit and proper test for external owners*

73. This section of the consultation paper contained several sub-issues:

(a) whether the test for external owners should be negative or positive, and the related issue of the usefulness of the FSA's regime as a model;

(b) whether there should be an additional test or tests for "controlled" interests above the 10% default threshold laid down in the Act; and

(c) whether 100% external ownership should be permitted.

74. From those who responded on (a), there was broad support for the SRA's provisional position not to require positive tests to establish probity or financial soundness (thus following the approach taken to the character and suitability of non-lawyer managers of an LDP). Several respondents thought the FSA's requirements were a useful starting point. However, the Institute of Legal Cashiers and Administrators and the City of Westminster and Holborn Law Society expressed reservations about the suitability of the FSA's regime as a model, in the light of the current financial crisis.

75. From an insurance perspective, Travelers argued that both ABS and traditional law firms should be subject to capital adequacy requirements. However, this was very much a minority view.

76. Amongst those who expressed a view on (b), there was support from the City of London Law Society and Association of Partnership Practitioners for the view that it may not be necessary or practical to have additional tests for those who own more than 10% of an ABS. However, a majority considered additional tests to be appropriate. Both Chester and North Wales Law Society and Hertfordshire Law Society felt that graduated tests should be applied to higher degrees of ownership and control. The Law Society took a similar view, arguing that "the higher the percentage owned by one individual, the more stringent the test should be, as the risk is raised", but did not indicate in what ways the test could be improved.

77. Responding as a "not for profit" (NfP) organisation, Shelter argued that, while NfPs should have to be licensed as ABSs, the fitness to own test would not need to extend ***"beyond that required by the Charities Commission and/or Companies House, except that no member of the governing body should have been struck off or barred from practice by a professional body"***. Similarly, the employer's association BPIF argued that NfP bodies should be ***"exempted from additional tests"***, because ***"ownership and shareholder pressure"*** would not be relevant.

78. On (c), there was general support (amongst those who expressed a view) for the proposition that external owners should be allowed to own up to 100% of an ABS, subject to the approval process. The Solicitor Sole Practitioner Group was against any majority non-lawyer control or ownership, but recognised that it might be ***"outside the remit of the SRA to be so restrictive"***.

79. Two general points were made by a number of respondents: first, the SRA should ensure that the test is proportionate and targeted, to avoid discouraging external investors; and second, that there should be a system of continual assessment to ensure owners remain fit to own an ABS.

80. Other comments:

- "… the same test should be applied once for any level of ownership … it would not be practical to have a subsequent 'gating' mechanism where there was a change in the level of ownership or control by a previously approved entity – such a mechanism could introduce uncertainty over the transferability of shares in ABSs and make them less attractive vehicles for investment." (CLLS)

- Many investing businesses are already regulated for financial probity e.g. by the FSA – the SRA could rely on these regulators' findings. Perhaps "the production of an accountant's certificate" confirming soundness would be sufficient. (A large firm)

- The test will not provide a "complete safeguard" against external pressure, so the SRA needs to identify ultimate beneficial ownership in ABSs. All owners should sign up to a "hierarchy of duties". (LSPI)

- "The safeguards of fit and proper person should apply whenever the percentage of ownership is increased by an existing minority owner through those limits [of 25-33% and 50%]." (SSPG)

- "The "fit and proper" tests that apply should be broadly similar to those used by the FSA across its various functions." (Co-operative Legal Services)

Conclusion

81. The SRA's approach should be:

- The fit and proper test for external owners should focus on requiring evidence which might indicate a lack of integrity, probity and financial soundness etc.
- The FSA's fitness tests should be examined further, particularly in relation to corporate ownership.
- Consideration should be given to a "gated" approach whereby the extent of the investigation increases dependent on the size of the holding, the most detailed investigation being triggered in the acquisition of a controlling interest, either through a new acquisition or an increase taking the owner above specified limits. Both fitness to own and assessment of adverse interest (see below) concerns would be reviewed.
- Further thought should be given to additional tests for holders of a "controlled interest" (above 50%).
- 100% external ownership should be permitted.

Issue F *Adverse interests*

82. In this section the SRA suggested that, where there is a potential for adverse interest, then where normal conflict rules would not be adequate, additional safeguards should perhaps be required. There was some support for that proposition and broad agreement on the cases identified by the SRA as involving potential adverse interests (legal expenses insurers, some claims management companies, financial services providers).

83. Respondents made a number of other suggestions as to organisations which might have or situations which might represent adverse interests, including the following:

- Under-settlement by an underwriter recovering its own subrogated outlay at the same time as recovering a client's uninsured losses. (Co-operative Legal Services)

- Investigation agencies, trade unions, newspapers and media, government agencies. (City of Westminster and Holborn Law Society)

- Agencies offering start-up packages to migrants wishing to set up small businesses. Agencies offering employment packages to migrant workers, such as security firms, private nursing agencies, catering firms, hotels or restaurants and firms employing seasonal workers. (OISC)

- ***"… claims being captured, 'sold', conducted and defended by the same insurance company"***. (LSPI)

84. There were few suggestions as to what safeguards could manage the risk but on the whole it was felt that conflict rules, transparency for the consumer, separation or ring-fencing to ensure the independence of the advice, and limiting external owners' access to client information were possible ways to mitigate or manage the risk. The LSPI and a large firm suggested that "sophisticated" clients should be able to opt out of the protection afforded by conflict rules.

85. Co-operative Legal Services pointed out that its Board and that of the group holding company had passed resolutions ***"noting that they have no right or jurisdiction to interfere in the way a legal instruction is pursued or handled",*** and suggested that the SRA may wish to require similar undertakings from all ABSs.

86. The CLLS suggested that ***"certain structural controls"*** might be needed, e.g. ***"regarding the level of information provided to investors and the degree of control of investors over business decisions"***.

87. The MASS took the view that it was insufficient to ***"place one's faith in the fact that the manager is a lawyer bound by professional rules", and that it would be necessary to "spell out both in the licence terms and as policy how it is intended to manage the risk where there are adverse interests or potential adverse interests".***

Conclusion

88. The SRA should proceed on the lines set out in the consultation - that adverse interests should be managed on a risk basis through normal conflict rules and by requiring additional safeguards, as suggested in some responses, in high risk situations, perhaps audited by the firm's Head of Legal Practice who would be accountable for their operation.

Issue G *The role of managers, HOLPs and HOFAs*

89. This section raised four main issues:

(a) whether ABSs should be required to have a majority of lawyer managers;

(b) whether HOLPs and HOFAs should be required to be managers;

(c) whether HOLPs and HOFAs should have to demonstrate competence for these roles through qualifications; and

(d) whether traditional law firms should be required to designate HOLPs and HOFAs.

90. On (a), there was strong support amongst those who expressed a view for the proposition that the SRA should not require a majority of managers of an ABS to be lawyers. Co-operative Legal Services, for example, suggested that such a requirement would be contrary to entity based regulation; while the ICAEW said it would ***"completely outlaw the possibility of … ABS with a majority of other equally well regulated professionals".*** However, some of those who were against a general requirement also considered that a majority of lawyer managers might be appropriate in certain cases – for example, where there was potential for adverse interests on the part of an owner.

91. Of the small minority who disagreed with the position taken in the paper, the SSPG opposed non-lawyer majority ownership or control of ABSs (while recognising that this was unlikely to be realistic); and the BSB (in its response to the LSB consultation) thought that, at least initially, there should be a requirement for a majority of lawyer managers ***"whilst the impact of non-lawyer managers on regulatory risk is assessed in the light of developing experience"***.

92. On (b), there was general agreement amongst those who responded to the question that appropriate accountability and responsibility were the key to the successful discharge of the roles of the HOLP and HOFA. Views were less clear on the issue of whether the HOLP and HOFA should be managers. The APP said that, given the seriousness of the roles, it would ***"usually expect the HOLP and HOFA to be a partner/director/member of the ABS".*** Similarly, the Immigration Services Commissioner felt that ***"as a general principle, [the HOPL/HOFA] should be partners or directors rather than employees"***, but accepted that the need for this might vary from firm to firm. The BPIF thought the HOLP and HOFA should either be managers or have to report to the Board of the ABS. The SSPG was more prescriptive in its approach, arguing

that the HOLP and HOFA should be both senior and hold a financial interest in the organisation.

93. Other responses (including those of the Law Society, Co-operative Legal Services and a large firm) highlighted seniority, experience and capacity to effect change as the characteristics which were essential to the roles, rather than being a manager. The LSPI considered that being a manager was desirable, but as a matter of good practice rather than regulatory requirement. Hertfordshire Law Society took the view that HOLPs and HOFAs could be employees.

94. In relation to (c), those who expressed a view were divided on whether a particular form of qualification should be mandatory for a HOLP or HOFA as a demonstration of competence for the role. Chester and North Wales Law Society, Hertfordshire Law Society, MASS, APP and a large firm generally felt that such a requirement would be over-restrictive and/or too burdensome for small firms. However, the CLLS, ICLA, and a large firm supported the idea that the HOFA should be qualified – either as an accountant or with an equivalent qualification/experience. The Law Society thought that ***"the HOFA may need a financial qualification or experience of handling financial matters"***, but stressed the need for flexibility coupled with guidance from the regulator. The ICLA felt that a HOFA needed more specific training than an accountancy qualification necessarily provided, and suggested a requirement for specialist legal financial training.

95. There was more general support for the view that the HOLP and HOFA should have to be able to demonstrate an understanding of the rules of conduct and regulatory regime, coupled with an acceptance by respondents that the required level of training and competence would vary with the risk attaching to the particular business model of the ABS.

96. The College of Law's Legal Studies Policy Institute proposed a more radical approach on the training and competence of managers, HOLPs and HOFA, which included (in summary) the following points:

- An assessment of management competence should apply to all managers, not just non-lawyer managers.
- Statutory provisions are ***"broad enough to support specific rules relating to the appropriate evidence of competence, education and training of the HoLP and HoFA"***.
- A person's being authorised does not necessarily mean he/she is fit and proper to be HOLP – e.g. notary or licensed conveyancer is not necessarily "fit" to be HOLP in ABS which does litigation or advocacy.
- Being a lawyer is not enough on its own to demonstrate competence to be a manager.
- In the public interest, ***"some degree of publicly verifiable qualification, certification or accreditation for the HoLP and HoFA should be explored as an alternative to the subjective and potentially self-justifying assessment by a firm of its own staff"***.

- Acceptable qualifications for a HOFA can be identified: chartered accountant, chartered secretary, chartered manager, or ***"possibly"*** an MBA.

- HOLP and HOFA ***"should either demonstrate that they have undertaken a (short) programme that equips them to understand the professional and regulatory framework of an ABS, or undergo an interview with the SRA to demonstrate that understanding (or both)"***.

- This approach would have implications for lawyers' qualification and CPD. There "might be" a case for specific training of those seeking designation as HOLPs and HOFAs.

97. From an insurance perspective, Travelers considered that ***"3 years post qualified experience, or 3 years relevant experience of managing service provision in a regulated environment"*** should be required of the HOLP/HOFA, in addition to "mandatory tests in relation to the conduct rules".

98. In response to the LSB consultation, Which? Argued that the roles of HOLP and HOFA are meant to ***"provide a level of accountability to each other"***, and that licensing authorities should accordingly require that one person could not perform both roles.

99. In relation to the issue of whether traditional firms should be required to have HOLPs and HOFAs ((d) above), a majority of those who commented (including the Law Society, CLLS, OISC, and the LCS) felt that this would be unnecessary and in some cases disproportionate, as the risks associated with ABS would not be present in a traditional firm. Of the minority who disagreed, the APP argued that there was a ***"cogent case"*** to extend the requirement to traditional firms, given the move to firm based regulation.

100. Shelter felt that special bodies should have HOLPs, but would only need a HOFA if they held client money. It did not believe that particular qualifications should be required for either role.

Conclusion

101. The SRA has been further developing its ideas in relation to managers, HOLPs and HOFAs in response to the consultation. The Legal Services Board is also developing its thinking in this area, and SRA policy will clearly have to develop in response to the LSB's lead. In the meantime, the SRA's provisional views on the matters discussed in the consultation are as follows:

- There appears to be no compelling case for generally requiring a majority of lawyer managers, but further thought will be given to whether this might be appropriate in relation to business models which could potentially involve "adverse interests".

- The HOLP is required by statute to be an authorised person. No additional formal qualifications should be required of the person fulfilling the HOFA role. Non-prescriptive, principles-based guidance might state that in situations of increased risk (e.g. certain complex organisations) additional qualifications or experience may be appropriate. However, for HOFAs who are neither qualified

accountants nor qualified solicitors, we may consider a demonstrated familiarity with the solicitors accounts rules (e.g. by passing the relevant Legal Practice Course module).

- In principle, there should be a range of experience requirements, judged according to risk, as part of the approval process for HOLPs and HOFAs. For HOLPs, we should work towards a threshold testable requirement around in depth knowledge of the rules of conduct and of management capability, perhaps coupled with manager status and a minimum three years post qualification experience, designed to provide the SRA with comfort that the individual is competent to enforce compliance in the business, and has the clout and standing to do so.

- Governance principles should influence and standing of the HOLP and HOFA, as these generally fit in with the SRA's developing risk-based, supervisory approach. More thought needs to be given on how these might be integrated.

- The fundamental issue for the HOLP and HOFA is that they have the necessary authority to influence and enforce (as necessary) high standards of compliance. This tends to suggest that a HOLP should normally be a manager but, in the case of the HOFA, there might be scope for greater flexibility.

- In relation to the training, competence and experience which might be required by all managers, the LSPI's ideas will be explored further. The Group considers that the current "qualified to supervise" requirement is unlikely to remain. Further work needs to be undertaken in this area, particularly with reference to the SRA's "Agenda for Quality" project, which seeks to introduce more outcome-focused quality assurance measures to regulation.

Issue H *Multi-disciplinary practices (MDPs): different service combinations*

102. In this section of the consultation the SRA stated that it did not intend to restrict ABSs to a form of ring-fenced entity which provides legal services, and asked whether any service combination should be prohibited within a multi-disciplinary ABS.

103. A majority of respondents who commented agreed with the SRA's initial view that it should not require all ABSs to be ring-fenced. However, the Law Society was more cautious, advocating ring-fencing ***"wherever firms are owned by business with other interests"***, to avoid uncertainty over the scope of the SRA's regulation. Hertfordshire Law Society went further, arguing that ring-fencing was the only feasible policy.

104. Those respondents who commented on service combinations were roughly divided on the issue of whether the conflicts involved in undertaking legal and audit work could be managed satisfactorily. Those who did not echoed the

common concern that the lawyer's duty of confidentiality would conflict with the auditor's duty of disclosure. The CLLS considered that, while accountants and lawyers should be able to practise together, it would be ***"necessary to prevent such lawyers from providing legal services to audit clients (either at all or in certain circumstances)."*** The LSPI argued that legal work and audit ***"should not be permitted within the same entity".***

105. However, a number of respondents disagreed with this, notably the ICAEW, which argued that it already regulates organisations providing these services, and that ***"The ultimate duties of confidentiality, and to act as a servant of the court or in the public interest, are similar. Appropriate professional requirements,*** conflict and practice management rules cover the position successfully."

106. On the question of other potentially problematic service combinations, the Law Society pointed to conflicts between insurers and clients, and expressed concern at the prospect of, for example, funeral services being linked to probate services.

107. Shelter said it could not identify any activities which it might undertake as an NfP which would be incompatible with legal services.

Conclusion

108. The SRA should not attempt to confine ABS to ring-fenced entities providing legal services. On the issue of incompatible service combinations, the SRA retains concerns over the ability of conflict provisions to overcome the difficulties of combining legal and audit work, and further consideration will be given to methods of addressing this, including discussions with other regulators. No other service combinations appear to raise comparable concerns.

Issue I *Insurance requirements*

109. The issues raised under this heading included consideration of the level of cover for ABSs, the role of the Assigned Risks Pool (which ensures client protection by providing insurance cover where firms are unable to secure it) in relation to ABSs and how to approach insurance of MDPs. The responses touched on various issues and demonstrated that there is perhaps an understandable lack of awareness of how the insurance system currently operates and its interaction with the Compensation Fund. It is therefore difficult to draw conclusions on some points in I and J (Compensation Fund).

110. There was, however, a large majority (20 of the 22 respondents on this) in support of the suggestion that ABS should be required to have the same level of insurance as traditional law firms. Which? and Consumer Focus also expressed this view when responding to the LSB's ABS consultation. In its response to the LSB, Which? highlights the risk of a damaging loss of consumer confidence in legal services providers if there is a failure to protect clients in relation to insurance and financial viability. Generally, respondents felt it important that clients receive the same level of protection, and that any

variation in the requirements for ABS would distort the level playing field amongst legal services providers.

111. The issue of "self-insurance" by ABS was raised by a small number but there was limited support – one respondent commented that there should not be exemption for an ABS because it is ***"a large organisation with deep pockets"***, with such recent examples showing that size does not indicate infallibility. Some respondents discussed the question of capital adequacy as a means of ensuring client protection. Overall this did not have wide support, although one of the qualifying insurers commented:

> ***"The public benefit of minimisation of business failure needs to be balanced against the risk that capital adequacy requirements are a barrier to entry. However, the very purpose of the changes is to allow more diverse investment sources. Capital adequacy requirements seem unlikely to obstruct investment, but complement it."***

112. One non-legal regulator put forward the suggestion of permitting an ABS to be covered by the insurance arrangements of the majority professional group in the ABS, even if this were not lawyers, to limit the complexity of insurance arrangements.

113. A number recognised the need to review the Assigned Risks Pool (ARP) arrangements. It was recognised that insurers have a role in risk analysis and that if an ABS could not find insurance cover then they should be regarded as unviable, so should not be able to have a licence and should not be provided cover through an ARP. Some felt this should apply equally to traditional solicitors' firms. [] Some practitioners expressed concerns about increasing risk and costs, whilst a current non-lawyer commercial provider of legal advice services felt that as the nature of services provided by ABS will be the same and will be supervised by lawyers there should be little impact on the ARP. Overall the feeling amongst respondents was that there should be a level playing field and ABS should therefore be entitled to ARP cover along with traditional firms. An alternative suggestion was to withdraw ARP cover altogether, although there would need to be some means of providing for public protection pending closure or disposal of a firm. This area will be explored further in the SRA's forthcoming consultation on the role of the ARP and appropriate future arrangements – this could radically alter the position if, for example, it is concluded that ARP cover should be significantly reduced or removed even for current firms.

114. A number of respondents recognised the difficulties in providing insurance in a multi-disciplinary practice although the general views were that this should not be a new problem for insurers and that it should be possible for one insurer to provide cover for the whole firm even where different aspects may need different levels of cover. It was generally felt that it would not be wise to create a scheme that required different insurance to cover different aspects of work within the same firm as that would cause confusion and would not operate in consumers' interests. Where it is difficult to draw a distinction between the different services of an ABS e.g. where legal advice is also provided by other professionals in the firm, one suggestion was that consumer protection may require all services, whoever provides them, to be covered by compulsory insurance. Overall there were strong feelings that

agreements, which would need to involve the insurers, should be sought to clarify how disputes over cover will be dealt with, and that there must be clarity for clients.

Conclusion

115. The SRA should:

- Adopt the proposition that clients of ABS should receive the same level of protection as clients of solicitors and LDPs.
- Consider further the concerns about the appropriateness of an ARP to cover ABS, particularly engaging with the qualifying insurers.
- Pursue discussions with insurers and other regulators to see how insurance to the specified level for legal services and other services as required can be provided.

Issue J *Compensation Fund requirements*

116. Almost all respondents who addressed the issue of the Compensation Fund agreed that it was appropriate for ABSs to contribute to a compensation fund for the benefit of their clients. Most respondents considered that it should be possible and was sensible to maintain one fund rather than to split the Fund so that there are separate funds for traditional firms/LDPs and for ABS. There was fairly wide recognition that contributions may need to be different to reflect risks, including those relating to financial viability of the body and holding client money, and to ensure that, for example, the traditional firm models did not contribute to losses caused by ABS and vice versa. As most respondents had indicated that the current terms for insurance cover should be maintained, this may have had an impact on views on the need to have two funds.

117. One respondent felt that the better course would be to require higher levels of insurance cover and to dispense with compensation fund cover, and a number suggested the use of a bonding scheme. Again, some respondents raised the need to consider requiring capital adequacy because of the risk to a fund of business collapse.

Conclusion

118. The SRA should consider how ABS could be included within a single compensation fund.

Issue K *Clarity for the consumer (descriptions)*

119. A large number of comments particularly from consumer bodies and other regulators noted that, for the consumer, the new world of legal service providers, with distinctions between traditional law firms, ABS and those providing unreserved work without regulation was likely to be more confusing. On the whole, clarity was regarded as a vital public safeguard – particularly

clarity as to whether the work was regulated, and if so who was dealing with the work and who regulated the work.

120. There was concern, particularly from current firms, that the title "solicitor" should only be used in connection with organisations involving solicitors. In the main this appeared to encompass bodies with at least one solicitor manager. There were differing views as to whether such bodies should only be able to use the title if they are regulated by the SRA, or whether it would be appropriate to do so where firms are regulated by one another Approved Regulator or Licensing Authority.

121. In contrast, a number felt that identifying the type lawyer is not the most important issue for consumers. One respondent had carried out independent research which showed ***"a high level of consumer ignorance about the structure and regulation of the legal profession"***. Comment was also made that solicitors' firms are rarely made up entirely of solicitors and will include other regulated, and non-regulated, individuals, so that giving the public a greater understanding of who is the regulator and what is the meaning of that in practical terms is a better approach than applying a professional title to an entire entity.

122. The Office for the Immigration Services Commissioner noted that the introduction of clear and meaningful descriptions, together with rules governing their use would protect consumers. The LSPI commented that:

> ***"…the unregulated delivery of non-reserved services by persons who are not otherwise authorised to carry on reserved activities will make it difficult to find identifying descriptions that avoid all potential client confusion. Nevertheless there are offences in the Legal Services Act (ss. 14-17) in relation to the use of authorised titles that should discourage unregulated individuals or entities from claiming or implying professional legal qualification that they do not have. We do not therefore believe that it should be necessary to define in licensing rules or other regulations the circumstances in which can be legitimately be applied by or in relation to the entities through which those individuals deliver the legal services."*** [Legal Services Policy Institute]

123. The arrival of new entrants, perhaps with a broader experience of consumer service and marketing is likely to have an impact on the presentation of lawyers and legal services provision. It was noted by one non-lawyer organisation, which currently provides legal advice services, that "***consumer education will fall to some extent to the LSB, however the advent of ABSs and more ready access to different providers of legal assistance, …believes that consumer knowledge and understanding will grow exponentially***". The concerns expressed by Which? in its response to the LSB's consultation, highlighting the risk of a damaging loss of consumer confidence, if inadequate client protections are put in place, seems equally a risk if consumers are not put in a position to make proper judgements about the nature of a variety of services and providers.

Conclusion

124. The SRA should:

- Pursue the proposition that only regulated firms involving at least one solicitor manager should be permitted to use the term solicitor.

- Explore, with the LSB, whether agreement can be achieved on the use of certain descriptive terms, and the best methods for improving consumer awareness and understanding of regulatory concepts.

Issue L *Conflict between different regulators*

125. The consultation identified the multi-disciplinary model of ABS as that most likely to create potential for regulatory conflict. However, the majority of those who responded did not appear to regard the problems of conflict among regulators as irresolvable, as most felt that there could be pragmatic solutions.

126. Other regulators who commented, such as the RICS and ICAEW, welcomed discussions but naturally also felt that any system of co-regulation should recognise the professional standards of others who are regulated and should not seek to add unnecessarily to the regulatory burden faced by a firm. The ICAEW response contained an appendix discussing a variety of models of ABSs between lawyers and accountants which could provide a useful starting point for discussions with them and the regulators of other professions. In particular, the ICAEW proposed that a regulator might delegate ***"part of its regulatory remit to another, by non-statutory agreement"***, to mitigate the impact of dual regulation. It also suggested exploring the potential benefits of joint inspections.

127. Other comments and suggestions included the following:

- "Consideration should be given as to whether majority representation [of a particular profession within an organisation] should be the threshold criteria for a particular regulatory regime and regulator." (Large firm)

- "[In an MDP] it may be necessary to ensure that the entire business is regulated by one regulator except to the extent that discrete parts of the business, e.g. audit and financial services, are clearly subject to established regulatory oversight." (APP)

- "Where firms are subject to regulation by other bodies, there will need to be sharing of information to ensure public protection." (TLS)

Conclusion

128. There is a major issue here which needs to be addressed to ensure client protection through the correct balance of regulation and the SRA should hold discussions with legal and other professional regulators, and with the LSB, to identify positive ways forward on the issues identified.

Issue M *Special and low risk bodies*

129. This section of the consultation discussed how the application of the rules might be modified for "special" bodies – independent trade unions, NfPs, community interest companies - and "low risk" bodies, in which non-authorised persons own and control less than 10 per cent of the ABS and constitute less than 10 per cent of the number of managers.

130. There was general support for the proposition that special bodies should be regulated as entities. A number of respondents made the point that certain risks may in fact be higher in such bodies although other risks lower, and that it was therefore important to have a proportionate and risk based regime. As the LSPI commented ***"the risks associated with poor advice or service resulting in complaints or disciplinary action, and the handling of clients' money, remain as real with special bodies as they do with law firms and full ABSs."*** The Law Society also pointed out that some not for profit bodies ***"may not always have a profit motive [but] … are still motivated to raise money"***.

131. The response from Shelter was particularly helpful. Licensing and entity regulation were needed for special bodies, it argued, because of the vulnerability of their client base, the nature of many of the organisations (which, being small, did not always have ***"the knowledge, resources or professional management which facilitate full regulatory compliance"***), and the ***"potential for tension where funders of services may be opponents in cases taken by agencies"***. However, in other respects special bodies presented lower risk because they were less likely to ***"be engaged in financial transactions"*** for clients, and were already subject to some regulation by the Charities Commission. Over-regulation might also precipitate a flight from providing regulated legal services and thus reduce access to justice.

132. These and other considerations led Shelter to a number of conclusions, including the following:

- Special bodies providing reserved work should be licensed and employ at least one authorised person;
- No fit to own test was needed beyond those required by the Charity Commission and/or Companies House, except that ***"no member of the governing body should have been struck off or barred from practice by a legal regulator"***;
- A special body providing more than legal services should not have to ring-fence the legal work because ***"the degree of risk of mis-use of client information (e.g. for cross-selling)"*** would not be present, allowing confidentiality to be protected through internal information barriers;
- Bodies should have to designate a HOLP and, where client money was held, a HOFA.

133. Some of these points were echoed in the response from the Advice Services Alliance: entity regulation should be introduced for special bodies; the regulatory regime should take account of the extent to which such bodies were already regulated to some extent by the Charities Commission, OISC, LSC and the FSA; HOLPs would be necessary but waivers of SRA

requirements might be needed; where client money was held there should be a HOFA – but special bodies were unlikely to be able to attract or afford a qualified accountant.

134. With regard to entity based regulation and special bodies, Shelter stated that:

"We … believe that entity based regulation should be extended to the not for profit sector, and thus that special bodies should be required to be licensed.

We believe that the SRA should use its discretion to vary the rules that apply generally so as to regulate special bodies in a way appropriate to the sector."

135. Amongst those who commented there was general support for the proposition that the SRA should start on the basis of dealing with each application from a special body on its merits but that it would be sensible then to translate requirements into rules. BPIF agreed with this approach, as did the Immigration Services Commissioner. As the Law Society pointed out, consistency of approach in dealing with applications from different bodies would be essential.

136. In relation to low risk bodies the paper proposed that the SRA could regulate these ***"as LDPs"***. This should more accurately have said ***"with the same requirements as are applied to LDPs"***, without additional ABS requirements, as the legislation would not technically allow them to be LDPs. A number of respondents, including the Law Society and the OISC, considered that this could apply, as now, to ABSs with 25% non-lawyer ownership.

137. Some respondents did not regard trade unions as particularly "low risk" bodies. ILEX commented that if trade unions were to offer legal services to non-members, they should be ***"subject to the same standards as mainstream practitioners, as concerns about the quality of advice and service will not necessarily differ between trade union services and private lawyer practices"***.

138. Other comments and suggestions included the following:

- "… given the potential for non-lawyers failing to understand or appreciate the statutory and professional duties associated with special bodies with an ABS licence, the express articulation of a 'hierarchy of duties' … would … be worth considering". (LSPI)

- "We believe that if licensing of special bodies is to be considered the example of the regulation adopted by the FSA and OFT appears to be a sensible model to follow." (Large firm)

- The National Occupational Standards developed by ILEX, TLS and the NfP sector could be used as "benchmarks to address the risk of varying standards of competency where volunteer staff and … paid non-lawyer staff … within not for profit organisations are the predominant frontline providers". ILEX

Conclusion

139. The SRA should proceed upon the broad basis proposed in the Consultation Paper, subject to further consideration with the LSB and potential special bodies.

Issue N *Other perceived risks*

140. Views were divided on whether or not regulation of the ABS should take into account financial standing and management of a firm. Some thought that this was too much for the SRA as a regulator to take on while others, such as Travelers, considered that such matters were proper for the regulator as otherwise insurers were in effect picking up a credit risk along with other risks. Some respondents felt that the model for the ABS might in itself create financial risk, which should be considered and dealt with at the point of application for a licence, either by turning down the application or by imposing conditions. Four respondents felt that the SRA should go further and consider imposing capital adequacy requirements for ABS as a whole. Of that four, one felt such a requirement should also be imposed on firms of solicitors and LDPs.

141. In considering the risks posed by ABS, some respondents mentioned the need for the SRA actively to supervise firms and the consequential impact on the SRA's resources, in considering licence applications, conducting monitoring and responding should an ABS collapse. This issue of resources covered not just overall levels of resources but also the skill base of staff. The Law Society commented that:

> ***"It is possible that new owners may set up complex business structures with multiple companies that may obscure risks arising out of the ABS. Regulators will need to ensure they have the systems and expertise to untangle these structures and consider the risks arising from them as part of a thorough "fitness to own" test and then to monitor ongoing changes both in the business and the market as a whole."***

Conclusion

142. The SRA should consider the best means of assuring the financial stability of firms, and ensure that it has the skills to regulate financial stability appropriately.

Appendix 1 – List of respondents

Regulatory bodies

- Bar Standards Board (BSB)
- ILEX professional services/ILEX
- Law Society of Scotland
- Institute of Chartered Accountants of England & Wales (ICAEW)
- Office of the Immigration Services Commissioner (OISC)
- Royal Institute of Chartered Surveyors (RICS)
- Judicial Appointments Commission (JAC)
- General Medical Council - Nil response
- Food Standards Agency – Nil response
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Representative bodies of Solicitors and others involved in current provision of legal services

- The Law Society (TLS)
- Lawyers with Disabilities
- Solicitors in Local Government (SLG)
- Sole Practitioners Group (SPG)
- Chester and North Wales Law Society (CNWLS)
- City of Westminster and Holborn Law Society
- City of London Law Society (CLLS)
- Hertfordshire Law Society
- Motor Accident Solicitors Society (MASS)
- Institute of Legal Cashiers and Accountants (ILCA)
- National Association of Licensed Paralegals

Solicitors' firms

- Plexus Law
- Addleshaw Goddard LLP
- Berwin Leighton Paisner LLP
- Irwin Mitchell

Other organisations

- Shelter
- Advice Services Alliance
- Legal Services Commission (LSC)
- Co-operative Legal Services Limited
- British Printing Industries Federation (BPIF)
- Council of Mortgage Lenders (CML)
- Association of Partnership Practitioners (APP)
- Travelers
- College of Law Legal Services Policy Institute (LSPI)

Appendix 2 – Law Society response