

## BUSINESS CASE FOR ABS REGULATION

### 1. Executive Summary

#### Introduction

Evidence suggests that the flexibility offered by Alternative Business Structures (ABS) will make this model the preferred choice by which legal services are delivered in the future. CILEx and CILEx Regulation are able to offer a unique contribution to this market for the following reasons:

- CILEx Regulation is a specialist regulator across the full range of reserved and regulated activities, which will enable them to bring new types of ABS into the market.
- the diversity of the CILEx membership (75% of our Authorised Persons are female and 65% of Practice Rights holders are female), which creates opportunities to increase the number of entities (both ABS and non-ABS) owned by individuals from diverse backgrounds, which in turn may contribute to the longer term solutions to restricted access to justice.

#### Strategy

The overarching strategy of CILEx is to grow the membership in 2 ways:

- to attract individuals currently working in the legal sector seeking to develop their career through CILEx, and
- to attract young people who have ambitions of a career in the legal profession.

In order to be attractive to individuals seeking to progress and succeed in a legal career, opportunities to own and manage a legal entity are fundamental.

CILEx has already committed to expand the career opportunities available to its members and others through the development and implementation of additional regulatory powers. This includes a long-term financial commitment to enable the regulation of legal entities owned by CILEx members. Part of this strategy is the regulation of ABS entities, as it is the fastest growing section of the legal services provider market.

The ability to establish entities, both ABS and non-ABS will enhance the attractiveness of the CILEx route to members and others and therefore fits with the overarching strategy of CILEx to grow CILEx membership.

#### Finance

The additional financial contribution required to support the application for ABS is approximately £26,000, which is included within the 2017 budget.

CILEx has already committed to the investment for the development and implementation of entity regulation and this is funded in the first instance from the CILEx reserves.

#### Target Market

CILEx Regulation has identified 2 key markets which will be targeted for ABS licensing:

- CILEx members seeking to set up their own small business and who want to bring in external expertise, such as financial or business knowledge and skills

- Businesses seeking to establish bolt on legal services to enhance the services they are able to offer, such as a company offering genealogy services which may want to add probate services currently outsourced to 3<sup>rd</sup> party suppliers

Although the market for firms seeking to switch regulators may provide a longer term area of growth, there are a number of barriers which will likely first need to be addressed before this becomes a viable option for most. These include resolving the issue of the requirement for PII run off and ensuring compensation fund arrangements protect consumers appropriately, access to lender panels and the current requirement of the SRA to rebrand existing firms who use the term 'solicitor' within their company name, to an alternative, where they cease to be regulated by the SRA as an entity.

### **Marketing**

A key element to the success of ABS licensing at CILEx Regulation will be the identification of, and commitment from, prospective ABS to be regulated through CILEx Regulation at the point of designation. In order to identify and gain commitment from these entities, significant marketing will be required.

Lack of visibility of both CILEx and CILEx Regulation in the wider legal services market has been noted through the research undertaken to support this application and also in related research conducted by CILEx to support their strategy to grow the membership more generally. Raising the profile of CILEx and CILEx Regulation will be central to the success of ABS licensing and as part of the wider CILEx strategy to grow the membership of CILEx.

CILEx committed to invest £50,000 marketing the regulation of entities including ABS by CILEx Regulation. This funding is spread over 3 years (2016-2018). This marketing will be used in 2017 by CILEx to generate interest in ABS licensing by CILEx Regulation and to create a base that CILEx Regulation can build from to meet and potentially exceed the budget targets over the next 3-5 years.

### **Conclusions**

This document has been designed to underpin the ABS application. The overall rationale for the approach proposed is set out in more depth within that document. This business case underpins that application and considers in more depth the financial and resource implications for regulating ABS, informed by the research and financial projections summarised below.

## 2. Analysis

CILEx Regulation has commissioned research with 4 groups:

- Owners of existing ABS
- Owners of new businesses established with legal services named as a function of the business
- CILEx members interested in entity regulation
- CILEx members who are self-employed but not currently regulated to deliver reserved legal activities.

Key findings from this research include:

- When establishing a new legal entity, whether a traditional law firm or an ABS, lawyers are most likely to choose the regulator linked to their own branch of the profession. Most do not consider an alternative regulator, but this is largely through habit
- CILEx members considering entity regulation, including ABS, are seeking autonomy, reward, work-life balance and personal development
- Of the new entities regulated through CILEx Regulation, 45% are owned by men. This is not reflective of the CILEx membership, of which approximately 75% are women<sup>1</sup>
- The CILEx qualifications, as currently structured, offer a proportionate approach to the development of knowledge, skills and competence and, as historically CILEx members have been employees, coverage of business management and accounts has been absent
- When considering a regulator other than the SRA, differentiating factors are key
- Perceived value which would differentiate an alternative regulator would come from: competitive costs, streamlined processes, tailored support and service aimed at smaller firms and additional services such as access to CPD activities
- CILEx and, by extension, CILEx Regulation is viewed as 'progressive and supportive'. However, most of this recognition of CILEx is as a law school and qualification provider
- Of the 12 new businesses interviewed, 8 were aware of CILEx but only 3 were aware of CILEx Regulation, similar responses were observed in the research with existing ABS'

In addition, the government and senior members of the legal profession have stated the importance of addressing issues in relation to access to justice and the need to increase the diversity of those offering legal services to the consumer.

The creation of CILEx as a Licensing Authority, able to authorise ABS, may address the issues identified above as follows:

### *Individuals regulated by CILEx Regulation*

There is a school of thought that those seeking legal redress are more likely to do so from legal services providers who reflect their own background<sup>2</sup>. The membership of CILEx is diverse and the ability of CILEx Regulation to authorise ABS will create the potential to increase the diversity of those offering legal services to the consumer. In turn, this may have a positive impact on addressing issues of access to justice.

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<sup>1</sup> Although the limited number of entities may impact on the validity of this data

<sup>2</sup> This information is based on research carried out by the SRA and can be accessed through the SRA website

Although CILEx members are able to access regulation of ABS through alternative regulators, the research indicates that those seeking regulation for an ABS are most likely to look to their own regulator for this.

CILEx members currently have the option to set up their own business through the existing regulatory framework. However, current entity regulation does not enable CILEx members to access expertise through investment and ownership in areas such as business management and accounts. The ability to regulate ABS will allow CILEx members to enter into business with those with expertise in other areas, and may encourage more members to establish their own businesses, thus enabling them to achieve their aspirations for autonomy and personal development.

### *Individuals regulated by other regulators of legal services*

A number of other regulators of ABS currently operate in the legal sector. The largest of these is the Solicitors Regulation Authority (SRA), which currently regulates the majority of ABS (and law firms) in England and Wales. The other regulators of ABS are CLC, IPReg, ICAEW and the Bar Standards Board (BSB). Each, with the exception of the SRA, entered the ABS market with a focus on using their expertise to create opportunities for particular sections of the legal services market.

The SRA has not restricted the ABS that they will regulate. However CILEx research indicates a perception that the SRA's approach to regulation of ABS is designed primarily to accommodate large firms. Smaller firms can find the process overly complex and bureaucratic for their needs. The findings of our research indicate that existing ABS firms regulated by the SRA found that the SRA lacks support for small businesses, with only large firms receiving the personal support of a dedicated account manager.

The research indicates that in the first instance, individuals will seek regulation for their business from their own regulator. However, this appears to be largely out of habit rather than a perception that their own regulator offers better regulation.

This means that in order to attract members of other legal regulators to CILEx Regulation, there must be differentiating factors which are attractive.

Key issues to be addressed are:

- Tailored support both through the application process and once licensed
- Streamlined application process
- Branding of law firms once they have switched regulators, where that brand may convey messages to consumers about regulation, e.g. reference to 'Smith & Smith Solicitors' and will also create practical problems such as new letterhead etc.
- Cost of regulation, including application fees, renewal fees, PII premiums and contribution to the compensation arrangements
- Availability of essential elements (such as access to lender panels for conveyancers)
- Access to additional services (such as CPD activities).

The regulator-switching market will not be the primary market for CILEx Regulation at the outset of ABS licensing however, as there are a number of additional risks that transfers in from other regulators will generate, including dealing with PII run off and compensation claims, which may arise once the entity has switched regulators. CILEx Regulation will need to assure itself that it is able to manage those risks before firms and ABS regulated by other regulators are targeted.

A key issue which arose from the research was the lack of awareness of CILEx Regulation as an option for regulation. Therefore a further issue to address is:

- Visibility of CILEx Regulation at an early stage of the decision by individuals to become a legal entity

### 3. Project description

- The project

The project is divided into 2 stages:

- Application for authorisation as a Licensing Authority
- If successful, implementation of regulation as an ABS

The application process is as follows:

<b>What</b>	<b>Who</b>	<b>When</b>
Submit draft application to LSB for comment	CILEx Regulation	<b>Complete</b>
Review feedback on draft application from LSB	CILEx Regulation/ABS Working Group	<b>Complete</b>
Gain access to First Tier Tribunal provision for appeals	CILEx Regulation	March – August 2018
Consultation on approach to ABS regulation by CILEx Regulation	CILEx Regulation	<b>Complete</b>
Approval of draft application	ABS Working Group	<b>Complete</b>
	FRSC	<b>Complete</b>
	CILEx Regulation Board	<b>Complete</b>
	CILEx Council	<b>Complete</b>
Create comms for submission of application	CILEx/CILEx Regulation	September 2017 and ongoing
Submission of application to LSB	CILEx Regulation	August 2017
Decision	LSB	Up to 12 months from submission, but likely to be January 2018

Implementation:

Both during the period between submission and decision and once the application has been approved by the LSB, CILEx and CILEx Regulation will need to undertake the following activities:

<b>What</b>	<b>Who</b>	<b>When</b>
Marketing of CILEx Regulation as an entity regulator	CILEx Regulation/ CILEx	On-going
Develop comms strategy	CILEx Regulation/ CILEx	September 2017 and on-going
Identify IT requirements	CILEx Regulation	September 2017
Review costs of application for regulation	CILEx Regulation	October 2017
Training for CILEx and CILEx Regulation staff	CILEx Regulation	October 2017

Website updates	CILEx/CILEx Regulation	October 2017
Implementation of IT requirements	IT/CILEx Regulation	December 2017
Review of entity application process to streamline	CILEx Regulation	December 2017
Develop policies, procedures, application documentation and guidance	CILEx Regulation	December 2017
Continue to pursue options for PII	CILEx Regulation	On-going
Continue to pursue lender panel solutions	CILEx Regulation	On-going
Consider other services which would provide added value to regulation by CILEx Regulation	CILEx/ CILEx Regulation	On-going

➤ Resources

- Existing staff at CILEx Regulation
- CILEx support based on existing SLA
- IT

➤ Budget

The cost of seeking approval as a Licensing Authority, over and above existing agreed outlay for entity regulation, is included within existing 2017 budget. This includes the following:

	<b>£</b>
LSB Application fee	22,000
Professional fees for amending rules	10,000
<b>TOTAL</b>	<b>32,000</b>

The budget is being carefully monitored and CILE Regulation remains within budget.

➤ Financial projections

The targets for new ABS applications have been agreed as follows:

**Table 1:**

<b>Year</b>	<b>New Applications</b>
2018	1
2019	5
2020	20
2021	20
2022	25
<b>TOTAL</b>	<b>66</b>

It is noted that CILEx Regulation is breaking into a new market, unlike the other entity regulators, who although they are new to ABS regulation are long established as regulators of law firms. Therefore, although there is an initial investment to establish ABS and entity, in the long term, there will be both financial and reputational rewards, particularly in relation to

the status of CILEx as one of the big 4 legal services regulators alongside the SRA, BSB and CLC.

The tables below set out the costs of application for and implementation of ABS licensing (over and above existing budgeted expenditure for entity regulation) against the benefits of CILEx Regulation becoming a Licensing Authority:

#### Costs over and above entity regulation costs

	Direct cost	Indirect cost
LSB application fee	22,000	
Rule amendments	10,000	
Staff time		Part of current staff responsibilities
IT changes		Can be included as part of CRM changes, therefore limited impact
Website changes		Can be included as part of regular updates, therefore limited impact
Committee time	Cost of ABS WG	
Consultation costs		Part of staff time
Staff training		Part of staff time + time for other staff members to be trained
<b>Total</b>	<b>32,000</b>	

#### Benefits over and above entity regulation benefits

	Tangible benefit	Intangible benefit
Increased options to meet/exceed entity sales targets	Positive impact on income to entity regulation from end 2018 – see targets for ABS approvals	
Economy of scale	ABS to be largely integrated into existing entity processes	
Seen as 1 of big 4 legal services regulators		Reputational benefit
Increased career opportunities for CILEx members making CILEx more attractive option	Positive impact on membership growth in the longer term which may impact on CILEx as well as CILEx Regulation	
Market trends in entity regulation	Evidence indicates this is the future of legal services delivery	
Increased customer base	Increased membership/entity subscriptions	
Increased customer satisfaction		Reputational benefit