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Dear Dawn

Application from the Chartered Institute of Legal Executives (CILEx) Regulation for a recommendation for designation as a licensing authority

Thank you for sending us the above application and formally requesting our advice in accordance with the Legal Services Act 2007 (the Act).

The CMA has a statutory duty under the Act to review applications for approved regulator and licensing authority status and provide the Legal Services Board (LSB) with such advice as we ‘think fit’ regarding whether the applications should be granted. In providing our advice we have to consider whether any given application, if granted, would, (or would be likely to) prevent, restrict or distort competition within the market for reserved legal services to any significant extent.

The CMA’s default position is that applications to become an approved regulator and/or a licensing authority are unlikely to raise any substantive concerns unless there is compelling evidence to show a significant detriment to competition,¹ since they are likely to increase choice for consumers and professionals. Where an application to become an approved regulator and/or licensing authority includes a provision that has the potential to restrict competition, this would need to be justified by one of the objectives set out in the Act.

The CMA notes that CILEx Regulation’s proposed licensing scheme for Alternative Business Structures (ABSs) broadly replicates the framework currently applied to non-ABSs entities. Specifically, both ABSs and non-ABSs will be required to:²

- make annual information returns and, where they hold client money, submit an annual accountant’s report, informing each entities’ risk profile;

¹ For example, through the imposition of disproportionate restrictions or where the new arrangements might result in a substantial degradation of consumer protection.

² Paragraph 36 of CILEx Regulation’s Licensing Authority Application

- be subject to first-tier complaints handling rules as set out by CILEx Regulation's Code of Conduct which require entities to signpost clients to the Legal Ombudsman for service matters (and to CILEx Regulation for conduct matters), enabling the escalation of high-risk events where these have not been resolved informally;
- have in place Professional Indemnity Insurance through a qualifying insurer;
- have to contribute annually to compensation arrangements set up to recompense clients of an entity regulated by CILEx Regulation who incur loss due to dishonesty or failure to account;
- comply with CILEx Regulation's Code of Conduct and Account Rules;
- be subject to the oversight function of the Strategic Risk Committee; and
- comply with the future CMA's requirements for provision of information.

The CMA also notes that CILEx Regulation's licensing framework includes some restrictions that will be specific to CILEx-licensed ABSs. Many of these additional restrictions are mandatory in nature as prescribed by Schedule 11 and 13 of the Act.³ These include, for instance, the requirement that ABSs must at all times have an individual who is designated as the Head of Finance and Administration and a Head of Legal Practice.

In addition, we understand that CILEx Regulation intends to exercise the discretion allowed by the Act to supplement the mandatory restrictions with additional regulatory rules which are specific to ABSs. These rules mainly relate to the authorisation and supervision of ABSs and are aimed at protecting consumers from specific risks that, according to CILEx Regulation, ABSs may carry.⁴ The additional rules concern:

- **Applicant's structure and business model:** CILEx Regulation intends to supplement Schedule 13 of the Act with Rule 3(3) of its Licensing Rules, by which an application may be refused if CILEx Regulation is not satisfied that the owners and managers as a whole are suitable to run a law firm. Similarly, it may refuse an application if it is not satisfied as to the approach proposed for managing the business or that required information has not been provided.

³ Schedule 11 sets out licensing rules. Schedule 13 places a duty upon applicants to identify 'material' (or 'restricted') interest holders in the business. It also includes criminal offences for failing to do so and includes broad powers for licensing authorities to seek information. The provisions require that fit and proper tests be applied to relevant persons throughout a structure, seeking out ultimate beneficial owners and managers as necessary.

⁴ After consultation with its Strategic Risk Committee, CILEx Regulation identified two ABS-specific risks:

- *Understand ownership and connected businesses.* CILEx Regulation considers it important that ownership and control in ABSs, which could in principle adopt a much more complex ownership model than traditional practices, are clearly understood.
- *Risk of undue influence* from non-lawyers on the standards within an entity. CILEx Regulation considers that, within ABSs, there could be a tension between commercial pressures and professional obligations.

- **Fit and proper checks.** Rule 3(3) of CILEx Regulation's Licensing Rules will also supplement section 90 of the Act⁵ to minimise the risk of undue influence. If CILEx Regulation, upon risk assessing an application and undertaking the appropriate fit and proper checks as regards investors, is not satisfied that the firm will comply with professional duties, then the application may be refused.⁶
- **ABS partnerships.** CILEx Regulation is proposing to exercise the discretion provided by Act, which provides⁷ that licensing authorities may deem all partners "restricted / material interest holders" who should be subject to the full fit and proper assessments.⁸

Advice

We have considered the application by CILEx Regulation and find no evidence to suggest that CILEx Regulation becoming a licensing authority under the Act would (or would be likely to) prevent, restrict or distort competition within the market, provided that CILEx Regulation's licensing framework (as set out in Annex 1 of the application⁹) provides sufficient consumer protections.

The CMA considers that allowing CILEx Regulation to license as ABSs firms to undertake the reserved legal activities for which it is authorised may strengthen competition and facilitate innovation in the legal services sector. For example, firms licensed by CILEx Regulation could act as an alternative to traditional suppliers (such as solicitors and barristers) in the conduct of the reserved activities for which CILEx Regulation is an approved regulator. This could place competitive pressure on the pricing of these services and broaden access to justice.

The CMA notes that, although the proposed licensing framework for ABSs broadly mirrors the framework that applies to non-ABS entities, CILEx Regulation proposes to apply additional regulatory rules which are specific to ABSs, to reflect the specific risks related to ABSs. We have considered whether these additional rules could make the licensing process more burdensome for applicants.

In this context, we note that CILEx Regulation intends to adopt a risk-based approach to licensing and supervision and therefore more detailed information from

⁵ Section 90 places a statutory duty upon all non-lawyer investors working in the ABS itself to not do anything which 'causes or substantially contributes to' a breach of the relevant professional obligations. Such individuals are therefore also directly bound to honour the same professional obligations as lawyers.

⁶ If issues are identified after a ABS licence has been granted, then under Rule 14(e) of Licensing Rules CILEx may revoke the licence if an owner has failed to honour the section 90 duty.

⁷ Schedule 13 (3) 2.

⁸ This control could operate distinct to the main tests for assessing materiality of ownership and influence in Schedule 13 which primarily relate to shares, capital held, profits and voting rights.

⁹ i.e. CILEx Regulation Licensing Rules.

applicants will only be required where a specific risk has been identified. As such, the approach that CILEx Regulation plans to adopt does not appear to us to be disproportionately burdensome.

Based on our assessment, none of the additional requirements appear to us to be unduly restrictive of competition. Furthermore, they appear to be broadly in line with other regulators' approach to licensing ABSs and as such do not appear to risk distorting competition by creating an unlevel playing field.

Yours sincerely,

A handwritten signature in cursive script, appearing to read 'Sharon Horwitz'.

Sharon Horwitz
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