

**Licensing Authority Application
CILEx Regulation
Representations
March 2018**

Introduction

1. In August 2017 CILEx Regulation submitted a licensing application on behalf of the Chartered Institute of Legal Executives (CILEx) to the Legal Services Board (LSB) for CILEx to become a licensing authority for alternative business structures (ABS).
2. As part of their decision-making process, the LSB is required to consult with the mandatory consultees who are the Competition and Markets Authority (CMA), the Legal Services Consumer Panel (LSCP) and the Lord Chief Justice. This is our written representation in response to the advice given by the mandatory consultees.

Background

3. Since 2015, CILEx members have been able to work towards setting up their own law firm, providing reserved legal services through authorisation by CILEx Regulation. This was a significant step forward in opening up opportunities to CILEx's diverse membership. More importantly for regulatory purposes, it was also an opportunity to expand the diversity of service providers available to consumers.
4. An ABS licence will open up further opportunities for CILEx members to set up their own law firm and to develop new business models, including seeking outside investment and business skills.
5. CILEx members have the benefit of operating within an outcomes focused, risk based, proportionate and flexible regulatory regime. Our conduct rules demand high standards of those we regulate but without being overly prescriptive or disproportionate. We believe that the ABS we seek to attract will have significant freedom to structure the business in a manner which best suits them and their client base without having to work around inflexible limitations.
6. Our approach to regulating ABSs broadly seeks where possible to:
 - apply existing standards for our CILEx Authorised Entities to ABSs; and
 - build upon the existing statutory framework and requirements for regulating ABSs and investors.

Advice and responses to mandatory consultees

Competition and Markets Authority

7. CILEx Regulation welcomes the CMA's view that they find no current evidence to suggest that by CILEx becoming a licensing authority under the Legal Services Act 2007 it would (or would be likely to) prevent, restrict or distort competition within the market provided that CILEx Regulation's licensing framework provides sufficient consumer protection.
8. We were pleased that the CMA believed that this may strengthen competition and facilitate innovation. They commented that firms could act as alternative suppliers to solicitors and barristers and so place competitive pressure on the pricing of services and broaden access to justice.
9. Our risk-based approach to authorisation is not seen as burdensome and they believe our requirements are broadly in line with other regulators' approach to licensing ABSs, and so do not appear to risk distorting competition by creating an unlevel playing field.
10. The CMA believes that none of the additional requirements we will put in place appear to be unduly restrictive of competition.

Legal Services Consumer Panel (LSCP)

11. The Panel found that CILEx Regulation had made a convincing case for the role ABS can play in promoting and enhancing diversity and innovation, as well as having demonstrated an appetite amongst our regulated community for establishing and using ABSs. They agree that ABS entities can be a vehicle for widening access, diversity and efficient services.
12. They supported our identification of two additional risk criteria: the importance of the regulator understanding the ownership of the business and the danger of undue influence. Whilst acknowledging the concerns about external investment and undue influence, they support external funding and investment, as long as consumers are protected.
13. In our application, we outline how we are proposing to address these issues within an updated risk framework, which the LSCP welcomed. Our approach to these issues will fit

with our strategy of ensuring that the risk framework reflects our policy of attracting businesses that are able to demonstrate they are specialists in their fields.

14. The Panel is supportive of our proposal to gather information about trends in conduct and service matters from our licensed bodies but want us to go further and to publish complaints data in a contextualised and meaningful way.
15. The Panel has emphasised the importance of implementing the CMA's recommendations around the provision of information on price and quality. They firmly believe that price transparency and information on quality is necessary to improve competition that delivers good consumer outcomes.
16. CILEx Regulation believes that with the current size of our regulated community, we have neither First Tier data nor any Second Tier data that will be meaningful to those looking at the legal market. It may also be possible to identify individuals from the publication of the data, when the pool from which the data set is drawn is small. However, as the number of firms grows, we will continue to monitor the approach of other regulators on the publishing of complaints data and will work to ensure that consumers have the information they require to make comparable and informed decisions about our firms in the legal market.
17. We are continuing our work on the implementation of the CMA requirements for non-ABS firms and will ensure that the requirements for transparency on price, service, quality and redress will be the same for both ABS and non-ABS firms.

Lord Chief Justice

18. The Lord Chief Justice has echoed the concerns of his predecessor, Lord Thomas, in terms of the basis upon which the Legal Services Act 2007 proceeds: that regulatory competition will improve regulatory standards and, therefore, further the public and consumer interest.
19. He was keen that 'regulatory arbitrage' or 'shopping around' must be avoided and that strong safeguards are in place to protect and promote high standards.

CILEx Regulation is pleased that he has acknowledged the key factor underpinning the application is to improve diversity in the legal market in a meaningful way, both in terms of the diversity of CILEx authorised individuals (who may go on to establish an ABS) and

by adopting a licensing process that is attractive to small and medium enterprises. He states that *'this approach is clearly a positive thing'*.

20. He has also noted that our research has demonstrated that there is often a 'natural choice' of regulator acknowledging that *'Given my general concerns about 'shopping around', I also consider this to be a positive thing and not something that regulatory arrangements should strive to change'*.
21. CILEx Regulation believes that CILEx provides a uniquely accessible route to qualifying as a lawyer and this has always offered a diversity of opportunity, which is borne out by the make-up of the CILEx membership.
22. Gaining the opportunity to run their own business was a significant step forward in opening up opportunities to CILEx's diverse membership and provides an opportunity to expand the diversity of service providers available to consumers. An ABS licence will open up further opportunities for CILEx members to set up their own law firm and to develop new business models, including seeking outside investment and business skills.
23. CILEx Regulation supports the desire for greater innovation in the legal sector and the CILEx membership brings a level of diversity which is unique. We believe that greater diversity of opportunity within the legal market can also assist in developing consumer choice and finding better ways to deliver better services.
24. Whilst expecting the majority of applications from CILEx members, CILEx Regulation will welcome applications from other authorised persons and different types of organisations. Our conduct rules demand high standards of all those we regulate, but this is without being overly prescriptive or disproportionate. We will be ensuring that this continues with our ABS firms.
25. We will explore with new organisations whether there is a way to widen choice to consumers by linking strong existing business services to the provision of legal advice to consumers via ABS. Through the mechanism of our risk framework, applied to all applicants (both ABS and non-ABS) we will ensure that:
 - the provision of legal services is related or associated to the core business,
 - that these firms are seen as specialists in their particular fields, and
 - that the possibility of undue influence has been assessed and mitigated.

Similarly, we will expect investment to be proportionate and to the long term benefit of the firm rather than be focused on short term return.

26. Where the application does not meet the requirements of the risk framework, we will not be able to license the applicant.
27. The Lord Chief Justice is reassured that our application is based on extension of the current non-ABS entity regulatory regime and also that we do not intend to license multi-disciplinary practices (MDP) in the first instance. He has stated the judiciary should be consulted if we were ever to seek this power.
28. We are conscious that we should ensure that all applicants (whether non-ABS or ABS) are assessed under the same regulatory regime. MDPs bring their own complexities for regulation and having sought advice from stakeholders, we believe that we should first develop our knowledge of standard ABS.
29. We believe that the flexibility of our existing regulatory arrangements mean that there may be advantages for applicants ring-fencing the legal services entity as a separate business. By adopting this approach it will provide clarity for consumers on the business relationship and ensure compliance with the future CMA transparency requirements. In addition it will help to address concerns around undue influence by providing certainty on the firm structure, ownership, management, associated companies, and financial arrangements. It will also enable us to be clear on the areas we are regulating and therefore the action we can take to revoke a license if our conduct rules are breached.
30. If, in future, there are benefits to us and CILEx members in seeking to license MDP, then we will ensure that we consult as appropriate with all stakeholders.
31. The Lord Chief Justice has acknowledged the work of our Strategic Risk Committee's input into fully understanding ownership and management structures, and guarding against undue or improper influence by non-legal owners. However he has questioned whether the present arrangements are sufficiently robust to guarantee this. The LCJ proposes that the LSB consider the BSB application to become a licensing authority as a possible alternative to the approach set out in the CILEx Regulation application. In particular, there are two points arising from the designation application made by the Bar Standards Board and the advice of his predecessor, Lord Thomas:

Head of Legal Practice (HoLP)

32. He is not persuaded that requiring the HoLP only to be an employee of an ABS is adequate. He advises the LSB to consider carefully this proposal and ensure there is appropriate parity with other licensing authorities.
33. CILEx Regulation made the decision to adopt rules governing the status of the HoLP similar to those that are in place with the Solicitors Regulation Authority, who are the largest regulator of licensed bodies. We would then reflect our expectations for the position of HoLP within our risk frameworks and these are set out below.
34. The licensing rules themselves address some of the Lord Chief Justices concerns by requiring that at least one manager of the applicant is an individual who:
 - (i) is an authorised person (within the meaning of the Act); and
 - (ii) CILEx is satisfied has the necessary competence in respect of any reserved legal activity which that body proposes to conduct;
35. This will mean that even if the proposed HoLP is an employee, there must still be an additional manager, who is an authorised person.
36. With the assistance of our Strategic Risk Committee, we will be formulating changes within our risk framework to reflect the types of firms that we expect to see applying to be regulated by CILEx Regulation. This will include the expectation of a HoLP as a manager or owner, which would be the usual type of structure we expect from CILEx members. This would include those members looking to add additional skills and/or investment to their firm.
37. CILEx Regulation believes that the assessment of the risk of having a HoLP as an employee is linked to the assessment of the risk posed by the ownership structure of the firm. These risks will be different for firms with a predominantly lawyer ownership structure from those with a non-lawyer ownership structure. Central to the assessment process is the application of the risk framework to any proposed application, the framework is overseen by the Strategic Risk Committee. The development of the framework for the assessment of ABS applications includes building in 'red flags' at certain points in the risk framework and these flags would be triggered, inter alia, based on the ownership and HOLP arrangements. Where more than one such flag arises in the assessment of the application, there will be a presumption to decline the application.

38. CILEx Regulation believes by providing a clear message to applicant ABS firms of our expectations, that we will be able to manage any risks that may be associated with the request to have a HoLP as an employee. We consider that this situation will be rare, but should this arise, an assessment of the risks posed by such an arrangement, set against the application as a whole, coupled with the rules in relation to ownership set out at paragraph 34 (which means that where the HOLP is an employee, there will be an authorised person owner within the firm) will enable CILEx Regulation to make an informed and balanced decision.

Improper influence

39. The Lord Chief Justice *strongly* recommends that CILEx Regulation revisit the decision to require only one manager to be an authorised person for a license to be granted. It seems to him that there is too great a scope for improper influence by non-authorised owners and managers. He says that '*The public interest rationale behind this concern, and an indicative approach to licensing that guards against it, are well articulated by the BSB in its designation application at paragraphs 3.2.4-3.2.7. Indeed, this measured approach was, quite rightly, commended by my predecessor at the time. It is a sentiment that I echo and I adopt his advice in this regard*'.

40. CILEx Regulation agrees with the view of the Lord Chief Justice that ensuring we address the risk of any scope for improper influence within an ABS is vital in protecting the public interest. Alongside that we need to ensure that we do not stifle the opportunities for CILEx members and encourage the diversity in providers that he has commented positively upon elsewhere in his response.

41. Our approach to the risks that an ABS poses was shaped by information from the MoJ consultation published in July 2016 and subsequent responses from the SRA, who were then licensing approximately 450 ABS. They commented that there was no evidence that an ABS structure is inherently more risky, nor is there evidence that undue influence is more prevalent within an ABS than a traditional law firm.

42. Consequently our view was that similar to other regulators, that whilst our rules may be set on a broad basis, we would look to manage the types of applications that we see through policies set via our risk framework. As highlighted within 36-37, we will be working with our Strategic Risk Committee on changes to our risk framework that will

both allow the flexibility in ownership of an ABS by spouses/partners (where one sees a 50% non-lawyer ownership) and recognise the risk that a 100% non-lawyer investment led firm could present to us and the public.

43. This will be set alongside our licensing by specialism, we will only look to regulate entities that are relatively low risk and straightforward. We believe this is important as this both restricts the opportunities for undue influence being exercised and allows us to focus our scrutiny on risk on particular areas of law, rather than those via an MDP say. There are other ABS regulators that may be more suitable in these higher risk situations. We also believe that by requiring legal services to be ring-fenced within a separate company, with its own managers, reduces that risk further.
44. We believe that having a robust policy underpinning our rules is important to allow sole practitioners to both recognise and bring in additional skills and investment in to their business, which may currently lack full transparency. For example a spouse/partner may put money in to set up the law firm by way of loan. Similarly we have examples of existing husband & wife businesses that would like to be regulated for reserved activities in the future, but need to be structured as an ABS.
45. These are types of firms that we would wish to see coming forward and so our rules and policies need to allow us to regulate them, whilst rejecting applications from those that are not meeting our expectations.
46. As part of our application process we will closely investigate the ownership structure to understand why legal services are being provided by applicant businesses. We would only expect these to be businesses where legal services are complementary to the existing business. Similarly we are not seeking to attract those businesses with external investment where this is predicated upon a short term return.
47. We understand fully the concerns expressed by the Lord Chief Justice especially in the light of the approach adopted by the Bar Standards Board within their submission. Within their application, they set out the policy for ABS based upon their existing role as a niche regulator of entities whose activities are broadly similar to those of barristers. However, the rules that underpinned that policy allowed them to be flexible in this approach, as they referenced with spouse/partner ABS.

48. Our application, whilst both highlighting the types of ABS that we seek to regulate and those that we would not, was based around the underlying rules with the policies to be overlaid following consultation with and approval by our Strategic Risk Committee. We have shared our initial thoughts with the Legal Services Board on the revised risk framework and how certain ownership and management structures will preclude certain types of ABS from obtaining a license.
49. We will continue to work with our Strategic Risk Committee to ensure we have a robust approach to licensing that protects the public and guards against the danger of improper influences.

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