

<b>To:</b>	Board
<b>Date of Meeting:</b>	12 October 2011
<b>Item:</b>	Paper (11) 73

<b>Title:</b>	Next steps for ABS
<b>Workstream(s):</b>	Workstream(s) 5B: Widening access to the legal market
<b>Author / presented by:</b>	Chris Baas, Project Manager chris.baas@legalservicesboard.org.uk / 020 7271 0055 Fran Gillon, Director of Regulatory Practice fran.gillon@legalservicesboard.org.uk / 020 7271 0087
<b>Status:</b>	Unclassified

<b>Summary:</b>
<p>October 2011 sees the introduction of the first Alternative Business Structures (<b>ABS</b>) into the market and the end of a significant part of the LSB's initial work programme. However, the start of the ABS regime will not be the end of the required work on the ABS project. This paper sets out the work required for the next phases of ABS and discusses some of the key timings.</p> <p>The key outstanding issues are:</p> <ul style="list-style-type: none"> <li>• the LSB as a Licensing Authority (<b>LA</b>)</li> <li>• ending the transitional protections for licensable bodies</li> <li>• the treatment of special bodies</li> <li>• dealing with new applications from Approved Regulators (<b>AR</b>) to become LAs</li> <li>• the Solicitors Regulation Authority's operation of a single compensation fund</li> <li>• evaluation and monitoring of ABS</li> <li>• multi-disciplinary practices.</li> </ul>

<b>Risks and mitigations</b>	
<b>Financial:</b>	N/A.
<b>FoIA:</b>	Initial assessment of exempted text is highlighted.
<b>Legal:</b>	No specific legal concerns.
<b>Reputational:</b>	The introduction of ABS is a significant part of the LSB's first set of priorities. The next steps outlined in this document are required to ensure that the change is fully implemented. This document also identifies an initial assessment of issues facing potential LAs.
<b>Resource:</b>	Much of the proposed work will require resource from Ministry of Justice ( <b>MoJ</b> ), which is under significant pressure to reduce staffing levels. We are meeting MoJ to discuss resource allocation and priority setting.

Consultation	Yes	No	Who / why?
<b>Board Members:</b>		✓	N/A.
<b>Consumer Panel:</b>		✓	N/A.

<b>Others:</b>	N/A.
----------------	------

<b>Recommendation(s):</b>
The Board is invited to note and to comment on the next steps for ABS.

## LEGAL SERVICES BOARD

<b>To:</b>	Board		
<b>Date of Meeting:</b>	12 October 2011	<b>Item:</b>	Paper (11) 73

### Introduction

1. On 6 October 2011, Part 5 of the Legal Services Act 2007 (**'the Act'**) will be commenced. It represents the beginning of the ABS regime. However, there are a number of outstanding issues that need further work from the LSB over the coming months and years.
2. This paper outlines several key issues and describes the required next steps for the LSB. A possible timeline for future developments is provided at **Annex A**.
3. Generalising broadly, none of the outstanding policy issues (with the possible exception of the special bodies regime) are likely to prove as controversial as the core changes made to enable ABS. However, all of them are, or have the potential to prove, complex in practice, and ensuring that the necessary effort is devoted collectively by LSB and MoJ may prove challenging. Controversy is more likely to arise in the context of applications for new LA status, in relation to which all of the currently known candidates present issues of some significant complexity.

### LSB as a LA

4. **What the issue is:** Once section 73(1)(a) of the Act is commenced, the LSB will be a LA. This section was not commenced with the other provisions of Part 5 of the Act. This was due to MoJ being uncomfortable with commencing these provisions without further work being done.
5. **Why it matters:** The Act gives the LSB a clear role and mandate as an LA. Furthermore, it provides provision for the LSB to be an LA of last resort if no other LA is able to do the job. To ensure that no legitimate potential ABS is left without a regulator and that the will of Parliament is properly reflected, this needs to be commenced.
6. **What is required:** The MoJ has undertaken to do more work on the issues to commence the relevant sections of the Act. LSB needs to ensure that proportionate preparations are made. Although technically an LA once the relevant sections of the Act are commenced, it is probable that the LSB will not need to use its powers in practice because the Council for Licensed Conveyancers (**CLC**) and the Solicitors Regulation Authority (**SRA**) are likely to be able to license all potential forms of ABS. The Act allows the LSB up to 12 months to prepare for the role once it has decided that an entity can apply to it for a licence. So a balance needs to be struck between doing enough to satisfy MoJ that we could fulfil the role, and wasting resources building rules, systems and governance for a function that the LSB may never exercise.

## Ending transitional protection for licensable bodies

7. **What the issue is:** The Act includes a transitional period for bodies which are currently regulated but which fall within the definition of a 'licensable body' under the Act (i.e. they have some element of non-lawyer ownership). There are such bodies regulated by SRA (LDPs), CLC, Intellectual Property Regulation Board (IPReg) and perhaps Association of Law Costs Draftsmen (ALCD). In order to end the transitional period, an Order needs to be made by the Lord Chancellor on the LSB's recommendation. The MoJ asked for a date for ending the transitional period and a paper was considered by the Board on 26 May. The decision was to end the transitional period in April 2013. However, MoJ subsequently requested more information about a number of issues.
8. **Why it matters:** In order to fully bring in the ABS regime, those who have been operating in firms that are ABS-like need to be licensed. This is not a particularly complicated issue, where the regulator has become an LA (e.g. for LDPs with non-lawyer owners who are currently regulated by SRA and can become ABS regulated by SRA). However, if the other regulators, such as IPReg, do not become LAs (or do not do so in time) when the transitional period comes to an end, these bodies will either have to change their composition or move regulators. IPReg is working to prepare a scoping paper this calendar year about its future role as an LA.
9. **What is required:** There is work to be done to end the transitional period. The Act allows for different periods to be prescribed for different categories of body. However, it needs to be determined if it is proportionate to end the transitional period for all bodies or if it equitable to allow some types of firm (and some regulators) more time to make an application as an ABS (or to become an LA). Engagement with the affected ARs will be needed, communication with affected firms will be required and drafting of the Order will require work with the MoJ.

## Treatment of Special Bodies

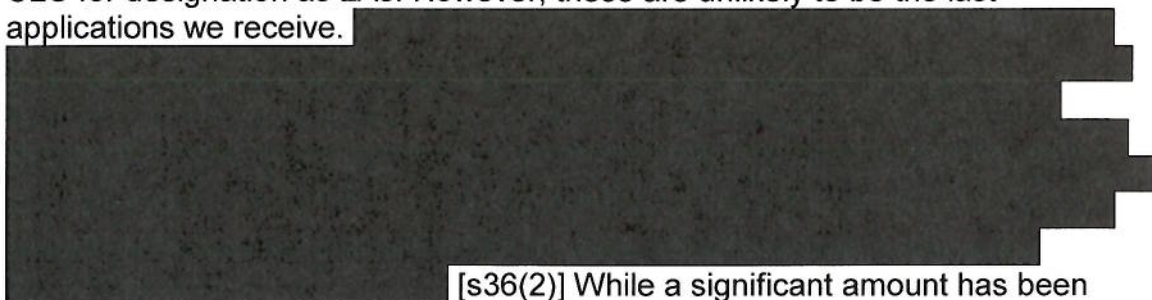
10. **What the issue is:** Under the Act, certain types of non-commercial legal services providers (not-for-profit bodies, community interest companies and trade unions) are given special provision. This means that, even though they fit into the definition of a 'licensable body' (section 72), they are entitled to carry out reserved legal activities without a licence for a 'transitional period'. Without the provisions in the Act, these bodies would need to be authorised and regulated in the same way as any other ABS. The only exception is trade unions, which under a specific exemption in the Act (Section 15) are able to provide certain activities to their members without needing to be regulated.
11. **Why it matters:** Parliament considered that Special Bodies may warrant some form of special treatment under the Act. A mixture of special provisions and transitional measures give some protection, but the Act also leaves open the issue for the LSB to consider. In particular, we must decide when to switch off the transitional protection. In order to make a recommendation to the Lord Chancellor, we need to better understand the risks to the regulatory objectives and potential consumer detriment, particularly as these decisions not only often concern vulnerable consumers and have an impact on organisations affected by reductions in legal aid, but also take place in the context of clear and consistent government policy to promote third sector economic activity and remove

unnecessary barriers. We must also consider the wider context of the Act and the presumption that the reserved activities (current and future) should be regulated at both individual and entity level.

12. **What is required:** Only the LSB can recommend that the Lord Chancellor should end the transitional protection. Once the transitional protection ends, these bodies may seek special treatment from the LA. We have said already that we consider the transitional protection should come to an end in 2013 (in our March 2010 ABS decision document). While our view has not necessarily changed, we need to do some more work to better understand the potential costs of regulation and whether bringing them into the ABS regime will mitigate the regulatory risks identified. Further consultation and engagement with the sector is needed. If we decide to make a recommendation to end the transitional provisions, we will also need to issue guidance to LAs on their treatment of Special Bodies and work with MoJ to develop the required Order.

### **New LA applications**

13. **What the issue is:** We have received and processed applications from SRA and CLC for designation as LAs. However, these are unlikely to be the last applications we receive.



[s36(2)] While a significant amount has been learned about what to expect from a set of licensing rules, each applicant will have its own set of issues to be identified and managed, much of which is likely to be highly technical. Each application will also result in affirmative Orders in Parliament to establish the appeals function and potentially to modify legislation.

14. **Why it matters:** The LSB has a clear statutory requirement to consider applications from bodies wishing to become LAs. The LSB needs to work with potential applicants to ensure that they have considered major issues prior to making an application. The LSB needs to maintain its capability to consider applications and to work with the MoJ to make the required Orders.
15. **What is required:** The LSB needs to work with potential applicants (see also ending the transitional period) in preparing and processing applications. This work does fit with the wider rule change work of the organisation, but is likely to be more complicated and more far reaching than most rule changes. As with the CLC and SRA applications, the assessment of capability will be important and it is likely that potential LAs will need to significantly build their capacity. This will require LSB to be able to assess their capability.

### **Compensation fund for SRA ABS**

16. **What the issue is:** The compensation fund for organisations regulated by SRA was extended in statute by a section 69 Order to include ABS firms. However, this was deliberately done with a 'sunset' clause that would unwind the

arrangements on 31 December 2012. This was done to provide SRA with sufficient time to conduct a review of all its client protection arrangements and to introduce changes if required. If that review provides evidence that it is necessary for the compensation fund to be replaced (or maintained), a new Order will be required. SRA wrote to the LSB in September outlining its initial proposals and has undertaken to further consider what more evidence it would provide to support its current view that a single fund should be continued.

17. **Why it matters:** Ensuring appropriate compensation arrangements is part of the required regulatory arrangements of an LA. SRA undertook to do a detailed piece of work to identify what the best solution would be for insurance and compensation. However, its focus seemed to be on the design of the insurance provisions, rather than compensation. SRA needs to make a strong case based on evidence and analysis so that the LSB can work with the MoJ to ensure that whatever solution is decided on is in place in time.
18. **What is required:** The LSB will need to understand the basis for SRA's preferred position once it has received the required analysis and evidence. It will then need to work with MoJ to develop a draft s69 Order (if it is needed), including an impact assessment, policy descriptions and briefings for debates.

### **Evaluation and monitoring**

19. **What the issue is:** The introduction of ABS is clearly a significant change to the regulation of the legal services market. In order to understand if the reforms have achieved their desired outcomes and whether the guidance for LAs is effective, the LSB will need to monitor the changes that occur.
20. **Why it matters:** All good policy making should be evidence based. For the changes brought about by the introduction of ABS, we expect that the market will change. So that we can evaluate the effectiveness of LSB and the LAs, we need to have good quality information about the impact of the changes. Also as part of the impact assessment process, the LSB has undertaken to evaluate and monitor the changes.
21. **What is required:** Much of the evaluation can, and should, be done as part of the wider research and evaluation work of the LSB. However, it is likely that specific research on the impact of ABS will be required. As part of the impact assessment process, the LSB has undertaken to assess the impact of various rules including the maximum financial penalty rules and the changes made under section 69. These assessments are expected to be done as part of a wider assessment of the impacts of the introduction of ABS in 2014 (or earlier if deemed necessary).

### **MDPs and managing multiple regulators**

22. **What the issue is:** There have always been some legal services firms that have been regulated by more than one regulator as they provide different types of services. With the introduction of ABS, the number and complexity of these multi-line businesses are likely to increase. With this will come challenges to the way regulators (and ombudsmen) work together.

23. **Why it matters:** Already there are issues raised by the group that represents solicitors who provide independent financial advice (SIFA) in relation to authorised professional firms who are regulated by both SRA and the FSA. We will be meeting with policy experts in SRA to discuss the particular issue. The Legal Ombudsman (**LeO**) has also raised wider concerns about jurisdictional boundaries in MDPs. SRA has asked for clarification from Office for Legal Complaints on the issue, but this has not yet been received. The introduction of ABS will increase the number and complexity of these businesses and the framework memorandum of understanding (**MoU**) that we have brokered is just the beginning. We will need to ensure that regulators do not put barriers in place to stop legitimate business arrangements. LeO is also concerned about the confusion that might arise from more complex business models and an associated increase in required resources.
24. **What is required:** LSB has been involved in the development of a framework MoU. This is now largely in place, but the issue of making it work in practice is still live. The LSB will need to work as a broker to ensure that regulators are thinking about these issues and sensible solutions are found.

**Other issues identified:**

25. **Costs protection:** Through the course of considering consequential changes for designating SRA as an LA, questions arose about the statutory right for clients to challenge costs in the High Court. Work has begun to understand the various protections afforded to consumers and perhaps identify areas for the removal of duplication and streamlining of processes. The protections in the Solicitors Act 1974 are not replicated for other regulators, but there have also been significant changes to the protections for consumers in general law since 1974. The costs protection work will consider what appropriate protections are and the best way of delivering them.
26. **Pll – run-off and switching regulators:** As more regulators become competent for more regulatory activities there is the increasing likelihood of firms switching from one regulator to another. Already this is happening with SRA-regulated firms switching to CLC. There seems to be particular issues around barriers to this switching with the design of insurance arrangements and potential issues around information sharing.
27. **Rehab orders:** The two rehabilitation of offenders exceptions Orders in 2011 covered HoLPs, HoFAs, and the one which is soon to be made covering those who hold a material interest in ABS. The regulators are keen for other roles to be included in the other types of entities they regulate. MoJ has agreed that these can be considered as part of its normal annual Order process. There is the opportunity to take a more consistent view of the exceptions and prepare a new business case for a new Order in 2012.
28. **Changes to the Bar:** As the changes to the Act begin to take effect, it is probable that we will see the structure of the Bar changing. Already the Bar Standards Board (**BSB**) allows dual practise – where a barrister can be both self-employed and work for a LDP. The Bar also does not have an equivalent of the separate business rule as can be seen by the encouragement of the ProcureCo model. Barristers will be able to form some types of entities – particularly those regulated by SRA, but it is likely that BSB will also aim to regulate these bodies.

We therefore should expect complex changes to BSB's rules and approach as well as probably an LA application.



**Possible timeline for future developments**

<b>Date</b>	<b>Issue</b>
October 2011	ABS day CLC issued licences active
November 2011	SRA appeals Order and Rehabilitation of Offenders Order made
December 2011	SRA designation Order
December 2012	IPReg decide on whether to make a LA application
January 2012	First SRA ABS licences issued
January 2012	Policy position on SRA ABS compensation fund finalised
May 2012	Possible application for LA designation from ICAEW
June 2012	Possible Rehabilitation of Offenders Exception Order
June 2012	Order on SRA compensation fund made
October 2012	One year of ABS – possible initial review point on take up and early adopters
April 2013	Transitional period for licensable bodies ends
June 2013	Possible end of transitional period for special bodies