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| **To:** | Board | | |
| **Date of Meeting:** | 25 January 2012 | **Item:** | Paper (12) 04 |

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| **Title:** | Licensing Authority restrictions on ABS |
| **Workstream(s):** | Workstream 5b: Widening access to the legal market |
| **Author / Introduced by:** | Fran Gillon, Director of Regulatory Practice<br>fran.gillon@legalservicesboard.org.uk / 020 7271 0087 |
| **Status:** | Restricted |


**Summary:**

Over the past few months we have had discussions with some potential licensing authorities ("**LA**s"). In slightly different ways, each of them wants to restrict the type of entity or individuals that they would regulate in Alternative Business Structures ("**ABS**"). This paper discusses some of the issues that this raises and asks the Board to confirm its position (see **Annex A** for current policy) that it will consider applications from approved regulators that do not have the capacity and capability to regulate all types of ABS but which do meet the other requirements of the designation process. In practice this means that:

1. we consider that regulatory arrangements that place restrictions on the activity that the LA will regulate (for example advocacy only or intellectual property only) based on the activities that they currently regulate are capable of meeting the requirements of the Legal Services Act and our rules;

2. by contrast, we will require considerable evidence to support applications with regulatory arrangements that restrict the types of business model that the LA will regulate (for example restrictions on the percentage of non-lawyer ownership); and

3. we will not countenance any attempt by an Approved Regulator ("**AR**") to seek to prevent the individuals whom it regulates from owning or managing a different form of ABS under the auspices of another Licensing Authority if the scope of such an entity falls out the "home" AR's jurisdiction.

Our experience of considering two licensing authority applications means that this is also a good time to seek the Board's continuing endorsement of key pillars of our policy towards potential licensing authorities:

1. that regulation of ABS should be based primarily on clear outcomes supplemented by guidance, with rules where there is only one appropriate way to ensure consumer protection and broader public interest. This is one of the factors we will be considering in our work on regulatory standards; and

2. that there should be one appellate body with sufficient resources and expertise to deal with complex issues, whose processes and costs are transparent, efficient, fair and public; that the appellate body is able to draw from experience across a wide range of regulatory issues and is able to come to consistent decisions about similar issues. This is something that we considered in developing our Guidance to LAs, although it is not included in the actual Guidance because further work was required.

Although this paper sets out briefly some of the current issues for the bodies that we know are considering applying to be licensing authorities, this is to put the discussion about specialised regulators into context and does not seek the Board's view on

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| whether those bodies should be designated as licensing authorities. |

| **Recommendation(s):** |
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| The Board is invited to confirm that:<br><br>1. it considers that regulatory arrangements that place restrictions on the activity that the LA will regulate (for example advocacy only or intellectual property only) based on the activities that they currently regulate are capable of meeting the requirements of the Legal Services Act ("**LSA**")and our rules;<br>2. it will require considerable evidence to support applications with regulatory arrangements that restrict the types of business model that the LA will regulate (for example restrictions on the percentage of non-lawyer ownership);<br>3. we will not countenance any attempt by an AR to seek to prevent the individuals whom it regulates from owning or managing a different form of ABS under the auspices of another Licensing Authority if the scope of such an entity falls out the "home" AR's jurisdiction;<br>4. for those ARs that anticipate becoming LAs, we expect their action plans on regulatory standards to be synchronised with their designation applications. For those bodies that are not currently either an AR or LA we will expect them to be able to show how they meet the requirements set out in the regulatory standards policy as part of their designation application; and<br>5. it continues to see merit in a single appellate body for appeals against decisions of ARs and LAs and that, pending further work on that issue, expects LAs to use the General Regulatory Chamber ("**GRC**"). |

| **Risks and mitigations** | |
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| **Financial:** | No specific financial risks |
| **Legal:** | No specific legal risks – although enforcing the approach set out here would undoubtedly lead to some push back from affected bodies |
| **Reputational:** | A change in policy would have an impact on our relationships with some ARs |
| **Resource:** | All LA applications take considerable staff resources. Current vacancies exacerbate the pressure on staff considering the applications. |

| **Consultation** | **Yes** | **No** | **Who / why?** |
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| **Board Members:** | | **X** | |
| **Consumer Panel:** | | **X** | |
| **Others:** | None | | |

| Freedom of Information Act 2000 (FoI) | | |
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| **Para ref** | **FoI exemption and summary** | **Expires** |
| 5,7,10,11,17 | FoI s36 – to allow free and frank discussion by the Board of the issues in those paragraphs | none |
| 13 | LSA s167 – the information is restricted information and must not be disclosed other than in circumstances specified in s168 | none unless LSA s168 applies |

**LEGAL SERVICES BOARD**

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## Licensing Authority restrictions on ABS

### The current position – Approved Regulators (ARs)

1. There are a number of dimensions by which ARs can restrict the types of authorised persons they regulate:

    a. Type of activity – for example conveyancing (Council for Licensed Conveyancers ("**CLC**")), associate prosecutors (ILEX Professional Standards ("**IPS**")), advocacy (Bar Standards Board ("**BSB**"))
    b. Structure of owners and managers – for example only allowing non-lawyer owners if they are also active in the firm's management (Legal Disciplinary Practices ("**LDP**s")) or percentage limits on the extent of non-lawyer ownership (Intellectual Property Regulator ("**IPReg**"))
    c. Type of practice – for example sole practice only (BSB), practice only as an employee (IPS), in partnerships (Solicitors' Regulation Authority ("**SRA**"))

2. These restrictions arise for historical reasons rather than evidence based regulatory rationale. However Licensing Authorities (LAs) will also have the ability to restrict not just the type of business structure (such as the extent or type of non-lawyer ownership) but also the width of activity that an ABS can conduct – for example restricting activities to advocacy services or to intellectual property services or by restricting the type of non-legal activities that the ABS can do. Whether LAs should be able to do this is a legitimate policy consideration for the LSB in its role of considering, as part of a designation application, the LA's proposed licensing rules and its overall capacity and capability. Since the approach to regulation taken by LAs will influence market entry and therefore the types and variety of services offered to consumers, our approach has impacts in particular on the regulatory objectives to improve access to justice, to promote and protect the interests of consumers and to promote competition in the provision of legal services.

**Potential licensing authorities - current discussions**

BSB

3. We are discussing with the BSB its approach to entity regulation and outcomes focused regulation. As part of these changes the BSB is considering applying to be a licensing authority. The BSB wants to be a specialist regulator for advocacy services (although we would need clarity on what this means in any licensing authority application) and wants the scope of services that a BSB regulated entity could offer to be similar in scope to those that the self-employed Bar can offer, including the ability to conduct litigation where authorised to do so. The BSB does not propose to let BSB regulated entities operate as MDPs (for example combining accountancy and legal services, or patent agent work and legal services).

4. The BSB's current approach is that there must be at least one barrister manager in a BSB regulated entity, who is also an owner. The BSB does not want to regulate entities that have external owners that are not also managers and will require all owners and managers to be natural (i.e. not corporate) persons. It considers that this would mean "a relatively simple and efficient regime for entities that are relatively low risk and/or where the risks posed are similar to those posed in regulating chambers of self-employed barristers".[1]

Issues raised [FoIA s36 applies]

5. [redacted]

[1] BSB paper to LSB: The BSB approach to entity regulation 1 December 2011
[2] Letter from BSB to LSB 3 November 2011

[redacted]

IPReg

6. IPReg currently regulates ABS-like entities with a variety of different ownership structures from very small businesses with an intellectual property attorney and spouse as managers/owners to a company listed on AIM. IPReg wants to become a licensing authority for firms specialising in intellectual property law. However, it can see benefit in allowing those entities it regulates to become MDPs – for example offering an entrepreneur financial and business planning advice as well as advice on patenting inventions. However, different approaches have different resource implications and its exact approach will be worked out over the course of the next few months.

   Issues raised [FoIA s36 appplies]

7. [redacted]

   ICAEW

8. The ICAEW is preparing its application to become an Approved Regulator (and possibly, at the same time, a Licensing Authority) for probate activities. It is considering whether it should regulate estate administration as well and we have encouraged it to keep abreast of our work on this issue. We have said that, if an accountancy regulator decides that it only wants to regulate probate activities in its capacity as an AR/LA, it will need to provide evidence about how it will ensure

that consumers understand that, once work on estate administration starts they lose the protection of LPP and potentially may have fewer benefits from the indemnification and compensation arrangements which would be essential for AR status, but could not be enforced in respect of that estate administration work. Our current view is that this is likely to be difficult to do in practice, particularly because the consumer is likely to be in distressing circumstances. There is an obvious overlap with our consideration of the regulation of will writing.

9. We have sent all the accountancy regulators a Q&A that draws together the main issues that have been raised with us.

   Issues raised [FoIA s36 applies]

10. [redacted]

11. [redacted]

    - [redacted]
    - [redacted]

    <u>Regulation of non-commercial bodies</u>

12. In due course, as discussed in the paper today on non-commercial bodies, once transitional protection is removed there will need to be a licensing authority to regulate non-commercial bodies such as Citizens' Advice Bureaux and Law Centres.

13. [redacted]

Advantages of allowing LAs to restrict ABS

14. For both consumers and businesses, restrictions may mean that regulators will design regulatory regimes fit for different needs. For example, a regulator for legal services provided entirely to business would necessarily have different arrangements to one that regulates entities that provides services entirely to vulnerable individuals. In addition, a regulator that covers the entire service offering of a business – such as an accountancy firm – may be able to provide a consumer with more clarity as to who the regulator is and the regulatory protections that exist throughout a series of, possibly quite different, transactions, thereby reducing the risk of regulatory overlaps or gaps.

15. Similarly it could be argued that such regulators will be more appropriate for specialist businesses. Their regimes may fit businesses better, be more flexible and the deadweight regulatory cost will be lower (no duplicate regulatory fees, provision of regulatory information, lower likelihood of regulatory conflict, etc). It may therefore provide more opportunities for different types of business model to enter the legal services market providing the LA can adapt its approach to regulation and recognise different types of risks posed by differing commercial approaches.

16. It would allow bodies to build on their existing sector-specific expertise and may therefore be a lower risk and quicker approach. It may also lessen the likelihood of delay in ending transitional period. However, there is still a significant amount of work to be done by all the organisations considering applying to be LAs to move to an appropriate outcomes and risk-based approach to regulation.

17. [redacted]

18. Allowing such regulators would be consistent with a shift to regulation based on activity (rather than on title), which itself is consistent with a targeted, risk-based approach.

[3] http://www.lawsociety.org.uk/documents/downloads/generalregulations05012012.pdf

Disadvantages of allowing LAs to restrict ABS

19. It reinforces the status quo, with a patchwork quilt of different approaches to regulation arising from multiple different statutory origins based on history rather than consumer need and resulting in increased complexity for businesses. However, that fundamental problem cannot be solved over the medium term timescales that we are considering for ABS.

20. Another disadvantage of such regulators may be an increased risk of regulatory capture. However, this may be more of a scale related risk rather than just simply related to the type of regulator and also one could argue that even scale or broad regulatory coverage doesn't necessarily diminish this risk.

21. If we do not allow restrictions then it is extremely unlikely that the BSB or IPReg will apply to be LAs (although ICAEW might). In that case, in the absence of the CLC increasing the reserved legal activities that it regulates, only the SRA will be able to license ABS that want to do litigation and advocacy. That could be seen as a move towards more consistency in the regulation of legal services, mitigating some of the concerns raised by the Smedley report on smaller ARs[4] because the number of firms regulated by smaller regulators will decrease over time.

Conclusion

22. Much of the concern expressed by LAs about regulating entities that are owned or managed by non-lawyers centres on the perceived risk that they will jeopardise the independence of lawyers in the firm because of a desire to maximise profit and/or because they are less ethical than lawyers. However, evidence to support these assertions has not been provided.

23. Linked to the assertions about non-lawyers is the issue of whether the potential LA has the capacity and capability to regulate a broad range of ABS (from micro businesses to listed companies). This can be mitigated by ensuring that, as for outcomes focused regulation (see paragraphs 26 and 27), we link our assessment of LA designation applications to the requirements in our approach to regulatory standards. By basing decisions whether to grant a licence on a proper (ie evidence based) assessment of risk, LAs will develop a targeted and proportionate approach to regulating ABS. Decisions to refuse a licence or impose conditions can be challenged by appeal to the appellate body. For potential LAs this means that they must be able to provide sector specific evidence for their approach and will have to fully explain their approach to risk assessment.

[4] http://www.legalservicesboard.org.uk/what_we_do/Research/publications/pdf/20110622_sar_report_final.pdf

24. We will, of course, consider each application on its merits. This will include consideration of the extent to which the prospective LA is capable of managing the level of complexity it introduces. (For example, a percentage share limit for non-lawyer owners might not reduce complexity to a manageable level in the same way that having a requirements for all owners to be active managers would.)

25. On balance, and particularly given the current restrictions on the SRA's ability to regulate firms that are solely non-solicitors (see paragraph 17), we consider that our approach should be:

    (a) that we consider that regulatory arrangements that place restrictions on the activity that the LA will regulate (for example advocacy only or intellectual property only) based on the activities that they currently regulate are capable of meeting the requirements of the Legal Services Act and our rules; but

    (b) by contrast, we will require considerable evidence to support applications with regulatory arrangements that restrict the types of business model that the LA will regulate (for example restrictions on the percentage of non-lawyer ownership); and

    (c) we will not countenance any attempt by an AR to seek to prevent the individuals whom it regulates from owning or managing a different form of ABS under the auspices of another Licensing Authority if the scope of such an entity falls out the "home" AR's jurisdiction.

**Outcomes focused regulation**

26. We have already signalled our expectations that ARs will move to regulation based on outcomes in our regulatory standards work which requires ARs to develop action plans. For those ARs that anticipate becoming LAs (and for those bodies that are not currently either), we must be clear that we expect their action plans to be synchronised with their designation applications – ie they cannot move more slowly on regulatory standards such as outcomes, risk and overall capability than their overall designation timetable.

Conclusion

27. For those ARs that anticipate becoming LAs, we expect their action plans on regulatory standards to be synchronised with their designation applications. For those bodies that are not currently either an AR or LA we will expect them to be able to show how they meet the requirements set out in the regulatory standards policy as part of their designation application

**Single appellate body**

28. When we published our Guidance to LAs, the accompanying decision document[5] said that we were attracted by the arguments that a single body would be able to develop consistency and share best practice for appeals but that it would not be possible to establish a single body to hear all legal services appeals prior to ABS going live. We said that we would continue to work with relevant bodies going forward. That work has not progressed as rapidly as we would have liked due to lack of resources. The proposal for a single appellate body has received Ministerial support during recent debates on ABS.[6] The CLC uses the General Regulatory Chamber (GRC) for its appellate body but the SRA uses the Solicitors' Disciplinary Tribunal. Our work on the enforcement element of regulatory standards includes consideration of the effectiveness of appeal processes.

29. We do not have the power to insist that LAs use the GRC since the prospective LA's consent is required under section 81(1) of the LSA. However, we propose that the guidance we publish on non-commercial bodies (see relevant paper of this meeting) should explain why we consider that the GRC is an appropriate jurisdiction for appeals from those bodies. We can have regard to the extent to which an approved regulator has complied with any guidance when considering whether to recommend designation as a licensing authority.

30. We will consider how best to allocate resources to taking forward the work on a single appellate body. However in the meantime, we recommend that the Board agrees in principle that this is a desirable course of action. The rationale for this includes the following:

    a. all LAs have the same enforcement powers. For example, financial penalties of up to £250m for entities and £50m for individuals, the ability to apply to the High Court for divestiture, removal of approval of Head of Legal Practice/Head of Finance and Administration, etc. These differ – often substantially – from their enforcement powers as ARs. There is therefore little justification for arguing that using the same body to hear ABS and non-ABS appeals means a level playing field; and

    b. different LAs are likely in the future to be regulating similar types of ABS. For example both the SRA and an accountancy body LA could regulate an ABS providing legal and accountancy services. In order to build up an appropriate body of expertise the point of reference for appeals against

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5 http://www.legalservicesboard.org.uk/what_we_do/consultations/closed/pdf/abs_guidance_on_licensing_rules_summary_of_consultation_and_response.pdf (pages 20-22)

6 For example: http://www.publications.parliament.uk/pa/cm201012/cmgeneral/deleg4/111123/111123s01.htm

these decisions should not, therefore, be to sector-specific appeal routes but to a single body.

Conclusion

31. We continue to see merit in a single appellate body for appeals against decisions of ARs and LAs and that, pending further work on that issue, expects LAs to use the GRC.

**Paper (12) 04 Annex A**

## Background – current policy

1. Our Guidance to Licensing Authorities[7] (LAs) published in November 2009 anticipated that not all LAs would be able to regulate all types of ABS. We said (at paragraph 134):

> *LA competence*
>
> *We recognise that there may be some LAs that will not be competent to regulate all types of ABS, in particular those with complex structures (whether external or lawyer only). A Licensing Authority's licensing rules should set out the type of ABS that can apply to it for a licence. If this places restrictions on the extent or nature of external ownership then this must be fully explained and justified. In these circumstances we would not normally approve the LA's licensing rules unless the relevant AR's regulatory arrangements were also changed so that they did not restrict an individual regulated by it (as an AR) from working in an ABS that was regulated by another LA with a wider range of competencies.*
>
> The document also stated (paragraph 75):
>
> *It may be that a LA considers that it is only competent to regulate entities with demonstrably similar risk profiles to those it already regulates as an AR. If a LA proposes licensing rules that place restrictions on the types of managers or the management arrangements that can by regulated by it, the LA must provide objective justification for the requirements.*
>
> The same document (paragraph 5) stated:
>
> *Regulating for outcomes*
>
> *We expect the regulation of ABS to be based primarily on clear outcomes supplemented by guidance, with rules where there is only one appropriate way to ensure consumer protection and broader public interest. In order to do this consistently across all LAs, we expect LAs to explain how they expect their licensing rules will support [a list of outcomes] and how they will monitor whether the outcomes are being achieved.*
>
> The Guidance also stated (paragraphs 22 and 23):

[7] http://www.legalservicesboard.org.uk/what_we_do/consultations/closed/pdf/abs_guidance_on_licensing_rules_guidance.pdf

*That there should be one appellate body with sufficient resources and expertise to deal with complex issues, whose processes and costs are transparent, efficient, fair and public; that the appellate body is able to draw from experience across a wide range of regulatory issues and is able to come to consistent decisions about similar issues.*

2. The LSA provides transitional protection for bodies which are currently "licensable bodies"; they do not need to apply for an ABS licence until the transitional period ends, which can only be done by the Lord Chancellor on the LSB's recommendation. At its meeting in May 2011 the Board decided that the transitional period should end in April 2013 for all licensable bodies except non-commercial "special bodies". We are discussing how to proceed with MoJ. In the absence of specialist licensing authorities, these ABS would have to apply to either the SRA or the CLC for a licence once the transitional period ends.