

To:	LSB Board	
Date of Meeting:	25 January 2012	Item: Paper (12) 05

Title:	Regulation of Non-commercial Bodies	
Workstream(s):	Workstream 3B: Widening access to the legal services market (see Business Plan 2011/12)	
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Status:	Protect	

Summary:

Non-commercial bodies are defined in the Legal Services Act 2007 (the Act) as Not for Profits, Community Interest Companies and Trade Unions (where certain services are provided to non-members). They have transitional protection from the requirement to obtain a licence by virtue of section 23 of the Act. The transitional arrangements can only be ended by the Lord Chancellor upon recommendation by the LSB. In order to make this recommendation, we have to ask ourselves what sort of regulation is required given the nature of the bodies, the services they provide and the clients they have. This paper sets out the basis of that policy which we plan to consult on in April 2012.

The Board is invited to endorse its previous decision that the transitional protection should come to an end, but that we should not make such a recommendation until we are content that an effective regime is in place. The decision to end the transitional protection therefore hinges on there being a competent licensing authority to regulate non-commercial bodies. Subject to consultation, we will issue outcomes focused guidance to prospective licensing authorities on what we expect this regime to look like.

Recommendation(s):

The Board is invited to:

- (1) Endorse the analysis and proposed approach
- (2) Agree to developing the consultation document and the proposed timeline

Risks and mitigations

Financial: Not applicable

Legal: Not applicable

Reputational: Failure to deliver an effective regime for non-commercial bodies could cause reputational harm to LSB and the prospective Licensing Authority, particularly if regulation is perceived as burdensome for Not for Profits

Resource: Currently sufficient

Consultation	Yes	No	Who / why?
Board Members:	✓		Barbara Saunders
Consumer Panel:	✓		Consumer Panel involvement throughout project
Others:	Representatives of the Not for Profit advice sector were updated and consulted at the November roundtable event. Individual meetings have also taken place and the level of engagement from key bodies has been positive (see paragraphs 10-13 in Annex A to this paper).		

Freedom of Information Act 2000 (Fol)		
Para ref	Fol exemption and summary	Expires
Annex A - 21	Section 42 – Legal Professional Privilege	
Annex A – 26	Section 36 (2)(b)	
Annex A – 24	Section 36(2)(b)	
Annex A – 29	Section 36(2)(b)	
Annex A – 31	Section 44 – confidential information provided to us in our role as oversight regulator	

LEGAL SERVICES BOARD

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Regulation of Non-commercial bodies

The issue

1. We have already made the decision that the transitional protection should come to an end and that non-commercial bodies should be subject to regulation where they provide legal services to the general public¹. The Board will remember that, in our decision document on the ABS guidance, we proposed that the transitional arrangements for non-commercial bodies should remain in place for 18 months after ABS have been permitted². The questions we now need to answer are what regulation should look like and when it should be introduced.
2. The starting point for considering the approach to regulation should be the mitigation of risks to the consumer. Non-commercial bodies often deliver identical services to the same sorts of clients as traditional firms. There is therefore a question around whether the level of risk is less, more or similar and what that means for the approach we take.
3. Our draft guidance will set out what we expect regulation of non-commercial bodies to look like. Before making a recommendation to the Lord Chancellor to end the transitional protection, we will need to be satisfied that the prospective licensing authority has complied with our guidance. While we will need to provide certainty on the timetable in the consultation paper, we also need to be clear in our messaging that we will not proceed unless there is a competent licensing authority in place to regulate non-commercial bodies.

What sort of regulation?

4. We have considered regulation of this sector in the widest sense, including:
 - Protections provided by existing membership networks such as Law Centres Federation and Citizens Advice
 - Charity Commission requirements
 - Procurement arrangements and the standards imposed by funders such as the Legal Services Commission and Local Authorities
 - A group licensing regime

¹ The transitional arrangements can only be ended by the Lord Chancellor upon recommendation by the LSB.

² LSB decision document, Alternative business structures: approaches to licensing: Guidance to licensing authorities on the content of licensing rules
http://www.legalservicesboard.org.uk/what_we_do/consultations/closed/pdf/abs_guidance_on_licensing_rules_guidance.pdf

5. We do not consider that the existing quasi regulation provided by procurement arrangements or membership structures alone provide sufficient consumer protection for the risks posed. Nor do we think that a group licensing regime would be appropriate. This is discussed further in paragraphs 18-22 in **Annex A** of this paper.
6. Many within the sector are calling for the transitional protection to end in order for them to compete on more of a level playing field, both in terms of tendering for contracts and in their ability to charge clients on both a commercial and cost recovery basis. The regulatory framework needs to be sufficiently flexible to adapt to these developments and ensure that any restrictions can be justified on the basis of risks to consumers.
7. The Act clearly envisaged that non-commercial bodies should be regulated as special kinds of ABS and we agree that this regime supported by clear outcomes focused guidance is the right approach. For the avoidance of doubt, we are not saying that everything should be regulated. The need for a proportionate approach has led us to advocate an activity based approach, whereby non-commercial bodies are licensed for the legal activities they provide and the regulatory requirements apply accordingly. This is discussed further in paragraphs 14-17 of **Annex A**.
8. As we have set out in the boundaries of regulation paper, regulation does not necessarily mean the way that it operates in legal services now. To the contrary we see this as an opportunity for all licensing authorities to take a truly outcomes focused approach and also take account of protections provided by the existing framework (such as membership requirements of national membership bodies such as Citizens Advice).
9. For existing licensing authorities, such as the SRA (which has made clear its intention to become the regulator of non-commercial bodies), this is likely to mean reviewing the suitability of its existing regulatory arrangements. For example, the minimum levels of professional indemnity insurance cover or the way that fitness and propriety tests are applied to owners and managers.
10. In particular, the Board is invited to endorse our view that the appellate body for non-commercial ABS appeals should be the General Regulatory Chamber. There is no new evidence to suggest that we should change that view but this may have implications for the prospective licensing authority (see paragraphs 6-9 in **Annex A**). This will need to be made clear in our guidance.

Next steps and timing

11. Subject to the Board's endorsement of our approach, the next step is to develop a consultation paper setting out both our wider thinking and the specifics of the guidance. Due to the links with the boundaries of regulation work and in particular the decision to look at general legal advice, we have decided to schedule the Special Bodies consultation paper for April 2012 (so it can be published alongside our decision document in relation to the former). Full proposals for the consultation paper will therefore come to the Board in March 2012.

12. We will continue to engage with key stakeholders as our thinking advances. This will include discussion with Ministry of Justice officials in relation to the commencement process and the timing of our recommendation to the Lord Chancellor. Officials have already indicated their interest in this area, mindful of the impact of legal aid changes on the voluntary sector. We recognise the importance of setting a clear and final timetable in the consultation paper as those affected are looking for certainty as far as is possible.
13. The final decision of whether to make a recommendation to the Lord Chancellor to end the transitional protection will be brought to the Board for consideration alongside the final guidance after appropriate consultation.
14. Subject to the outcome of that consultation and Board approval, we plan to issue our final guidance to licensing authorities in September 2012, after which we will work with the current and potential licensing authorities in developing their approach in the build up to lifting the transitional protection.
15. While the specifics of the required commencement orders and sequencing are subject to agreement with the Ministry of Justice, we are working towards switching on the relevant sections of the Act to enable applications from Special Bodies to be made from June 2013. This is, of course, subject to consultation and final decision by the Board. They will then be given a period of 6 months to obtain a licence before the transitional protection ends in December 2013.

Paper (12) 05 Annex A: Further Background and Policy Discussion

Special Bodies Regime

1. The ABS regime means that legal services providers with non-lawyer owners and/or managers need to be licensed to provide reserved legal activities. This includes non-commercial bodies (Not for Profit agencies, Community Interest Companies and, where certain services are provided to non-members, Trade Unions³). However these bodies are given protection for a transitional period, which means that they can provide reserved legal services without a licence.
2. Once they are brought within the licensing regime, these „Special Bodies’ can apply for special treatment from the licensing authority through modification of the licensing rules (subject to certain exceptions).

Low Risk Bodies

3. Low Risk Bodies are defined in section 108 of the Act as commercial bodies with at least 90% lawyer ownership. Low risk bodies may also seek special treatment but they are different from the other categories of Special Body because, as commercial bodies, they are not defined in section 23 of the Act and therefore not covered by the transitional protection. In practice these are likely to be traditional firms with a small amount of external ownership, which in theory could apply for special treatment from the licensing authority.
4. It is unlikely that the LSB would have established either the principle or the nomenclature of “low risk bodies” had the decision been ours. One option would be to choose not to switch on section 108 of the Act and therefore prevent these organisations from being able to apply to the licensing authority for special treatment in the same way as non-commercial organisations. However we do not consider that this approach would either reflect the will of Parliament or be sufficiently flexible. While we do not anticipate any circumstances where a licensing authority would alter its requirements for these bodies, particularly given the SRA’s unified approach to regulation of ABS and non-ABS, this should be a decision made by the licensing authority and not the LSB.
5. We are therefore planning to propose an approach whereby all of the Special Body provisions in the Act are switched on. Our guidance will then set out a view that decisions regarding alterations of licensing rules for low risk bodies need to be risk based and that we cannot identify any specific examples where it would be appropriate to lower or alter the standards required in the licensing rules.

Appeals

6. Licensing Authorities will need to ensure that there is a route of appeal for all decisions on modification applications. This is already made clear in our supplementary guidance on appeals against decisions of licensing authorities⁴.

³ Section 15 of the Legal Services Act 2007 means that Trade Unions do not require a licence to provide reserved legal services to their members after the transitional period has ended

⁴ http://www.legalservicesboard.org.uk/what_we_do/consultations/closed/pdf/supplementary_guidance_on_licensing_rules.pdf

7. We consider that the General Regulatory Chamber is an appropriate jurisdiction for appeals from these bodies and propose to consult on this basis (see paper (12) 04 Licensing authority restrictions on ABS).
8. Our decision on whether to end the transitional protection will need to take into account the extent to which the prospective licensing authority has complied with our guidance, including the position on appeals.
9. The appeals body for a particular licensing authority is set by affirmative order under Section 80 of the Act. For the SRA, this is the Solicitors Disciplinary Tribunal (SDT). Should the SRA become a regulator of Special Bodies, then the SDT jurisdiction would include decisions about modifications to licensing rules for Special Bodies unless a separate order is made in relation to the GRC.

Sector Engagement

10. Throughout this project we have sought to engage with organisations representing those affected. We have also worked closely with the Legal Services Consumer Panel as opposed to requesting the Panel's formal advice (although we retain the option to do so).
11. The work undertaken by Frontier Economics⁵ and our own analysis demonstrates that most of those affected by the end of the transitional arrangements, i.e. those that will require a licence to continue operating, are likely to be Not for Profit advice services employing solicitors. Trade Unions provide mainly services to their members and will not require a licence to continue to do so⁶. We have therefore focused our engagement with representative bodies for such organisations such as Advice Services Alliance, Citizens Advice, Law Centres Federation and Advice UK. However, in opposition, Conservative spokesmen indicated that they would wish to end the Trade Union carve out and it is therefore important that our proposals are flexible enough to work in that event, should there be any primary legislation to that effect in the medium-term.
12. At a roundtable event in November 2011 chaired by LSB Board member Barbara Saunders, we set out our early thinking in terms of both policy and timetable. The level of engagement was very good and attendees welcomed the opportunity to input at an early stage in our policy development. There was a strong focus on getting to grips with the detail and calls for simplicity and clarity in approach. No objections were expressed in relation to regulation in principle but this is not surprising given the group and the concerns about the direction of travel for funders commissioning advice services.
13. We will hold another similar event during the consultation period but will stay in touch with key bodies in the intervening period as this input has proved invaluable. We are also mindful that the involvement of the sector's representative bodies will be integral in informing prospective Special Bodies

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http://www.legalservicesboard.org.uk/news_publications/latest_news/pdf/rep_lsb_special_bodies_final_report_07_07_11_stc.pdf

⁶Section 15 of the Legal Services Act 2007 provides specific exemption for the provision of "excepted membership services", that is the provision of some specified legal services by independent trade unions to their members. So even if the transitional protection is lifted, independent trade unions will not require a licence if they wish to provide services only to their members

and in bringing organisations into compliance. It is therefore important that prospective licensing authorities do the same.

Activity based approach to licensing

14. A key issue that was highlighted at the roundtable is the clear connection to our work on assessing the boundaries of regulation and particularly the starkness of the issues when you consider the impact on a recognised brand such as the Citizens Advice Bureaux (where those doing small amounts of reserved activities would be regulated when many others, not doing reserved, would not).
15. Concerns were also raised in relation to the potential for “regulatory creep” whereby everything that an organisation does would be subject to regulation and the subsequent challenge of defining what we mean by „legal services’. Of course these are also issues for commercial service providers and while one option would be to delay implementation until the issues around the boundaries of regulation are resolved, we do not consider this to be sufficient justification for continuing with a framework whereby consumers of not for profit providers are afforded less protection than mainstream legal services consumers.
16. Given the importance of proportionality and the potential impact of an overly burdensome regime on access to justice, we have an opportunity to advocate a slightly different approach for Special Bodies. We are therefore proposing an activity based approach whereby Special Bodies would be licensed for the particular legal activities they provide, achieved through conditions on the licence⁷. This does not mean regulating everything and to the contrary, would enable the regulatory requirements to be proportionate and targeted at real risks - for example, client money handling rules or professional indemnity insurance requirements may be significantly reduced or even totally unnecessary depending on the precise range of services offered. Of course those looking to move into more commercial, and higher risk areas such as will writing (as a way of supplementing their income) would be subject to the same requirements as a commercial provider with a similar profile of work.
17. There was some support for this approach at the roundtable but attendees also identified some issues such as how to define activity, the extent of regulatory reach (for example access to the Legal Ombudsman in relation to services provided by volunteers) and consumer confusion around what is or is not regulated. These issues will need to be addressed through the consultation process.

Group Licensing

18. We expect some to call for a group licensing regime for Special Bodies akin to the OFT scheme for consumer credit⁸. The OFT is able to issue a group licence where doing so would serve the public interest and has indicated in its guidance

⁷ Provided by section 85, paragraph 5 of Part 5 to the Legal Services Act 2007

⁸ Set out in the 1974 Consumer Credit Act

that organisations undertaking credit activities on a non-profit basis are likely to be lower risk and therefore suitable for such an approach⁹.

19. From a policy perspective a convincing argument can certainly be made that some form of group licensing would be a proportionate approach to regulating Special Bodies, particularly where organisations such as Citizens Advice already have in place membership standards and agreements between national and local bodies.
20. Our starting point for this work has been to look at the extent to which these organisations are regulated already and identify gaps. However, we do not consider that the case made for consumer credit (i.e. that the absence of a profit motive reduces risk), necessarily applies to legal advice where there are significant risks around competence and quality both in terms of advice provision and governance. A group licensing regime may not necessarily address all of these risks and may have the added effect of placing a significant compliance burden on the lead body which in reality would be taking on the role of regulator. Furthermore, where the lead body has a significant representative function this may also have implications for regulatory independence (and look like self regulation by another name).
21. In addition to these policy considerations, we have sought legal advice on the viability of a group licensing regime in legal services regulation. Our internal legal advice states that while the LSA does not explicitly prohibit group licences, its drafting does not facilitate them and that each body would need to have its own licence. Where each member of a group is a Licensable Body, it will need to possess a licence in order to conduct reserved legal activities.
22. Having considered these issues we therefore do not consider group licensing to be the right approach. However this is not to say that a licensing authority should not take account of existing structures and processes (such as insurance, case management systems or audit), many of which may be provided through a national umbrella body, in their approach to risk assessment and supervision.

Prospective Licensing Authority

23. It is anticipated that the SRA will be the only body that is willing and able (in terms of the reserved legal activities it can regulate) to license Special Bodies. We have had a number of discussions with the SRA on its likely approach. A representative from the SRA also attended the roundtable discussion in November. The SRA has stated that its starting point will be for the Handbook requirements and usual regulatory approach to apply unless there is a very good reason why not.
24. [REDACTED]

⁹ The OFT also considers the primacy of credit activities as a risk indicator, see OFT Guidance for consumer credit group licence holders (updated August 2011)
http://www.of.gov.uk/shared_of/business_leaflets/credit_licences/OFT990rev.pdf

25. While there is no formal designation process for the SRA to become a licensing authority for Special Bodies, it will need to amend the Handbook to allow for applications to be made under the Special Bodies regime in section 106 of the Act. As with all changes to regulatory arrangements this will be subject to LSB approval and we will need to be satisfied that the SRA is competent to carry out the proposed changes. Specifically we will need to be satisfied that the SRA is able to receive applications for modification of its licensing rules and make risk based decisions on how to apply its licensing rules in these circumstances. We will also need to be satisfied of the SRA's ability to supervise and regulate Special Bodies.

26. [REDACTED]

27. We have suggested that the SRA considers the suitability of its current regulatory arrangements in the context of Special Bodies. Not only its rules but also risk assessment and supervisory approach. This should involve consideration of which requirements are likely to be unnecessary or unsuitable and also where there may be areas of risk that the current arrangements do not address. An example of this may be how the ownership requirements (i.e. fitness and propriety tests) applies to Special Bodies or whether the minimum terms for indemnity insurance should differ.

28. The Board should note that it is not possible for an existing Licensing Authority to develop an entirely separate set of licensing rules for Special Bodies. That is not to say that they cannot review the applicability of the rules to certain types of body and amend them on that basis. Another option would be to issue guidance on how the existing rules are likely to apply to Special Bodies to give a steer for modification requests. Either approach would need to take account of any guidance issued by the LSB. For any Licensing Authority this is an opportunity to develop its outcomes focused approach and in particular, consider whether rules need to be changed where they are causing multiple modification requests.

29. [REDACTED]

30. It is our view that, although there are no explicit statutory requirements, we should not make a recommendation to the Lord Chancellor until we are confident that there will be in place an appropriate licensing authority. This presents some risk of delay.

31. [REDACTED]

[REDACTED]