SRA response to the Legal Services Board's discussion paper "Wider Access, Better Value, Strong Protection"

Introduction

1. The Solicitors Regulation Authority ("SRA") welcomes the opportunity to contribute to the Legal Services Board's ("LSB") discussion paper on the development of the regulatory regime for alternative business structures ("ABS"). The changes discussed in the paper will lead to greater choice and accessibility for consumers to high quality and good value legal services from a broad range of new providers as well as those already established in the market.

2. The SRA will be seeking licensing authority status from the LSB and on 1 June we issued a discussion paper on regulating ABS. This is intended to add to the debate being led by the LSB and to help us in our approach to the regulatory developments needed. It can be found on our website at www.sra.org.uk/sra/consultations/2786.article and asks for comments by 31 August 2009.

Timeline

Question 1 - What are your views on whether the LSB's objective of a mid-2011 start date for ABS licensing is both desirable and achievable?

3. We share the LSB's objective of delivering the changes needed for ABS by 2011. We believe this is achievable but is also a challenging goal. Having implemented the first set of changes anticipated by the Legal Services Act ("the Act") enabling legal disciplinary practices ("LDPs"), we are conscious that working towards ABS will be a considerable further step for the SRA (and no doubt the other regulators). The delivery of ABSs is part of a wider programme to develop principle-based regulation of the legal sector, but we consider that ABS licensing should not be held back by wider reforms.

4. Major changes will be needed to achieve ABS including, for example, extensive review of existing rules, new sets of procedures, development and application of new IT as well as statutory changes to enhance regulators powers. We believe that close interaction with the LSB and other interested stakeholders on the frameworks that will be needed will be essential in achieving the goal within the timeframe. In the meantime we look forward to the LSB's draft guidance referred to in paragraph 3.5.

Question 2 - How do we ensure momentum is maintained across the sector towards opening the market?

5. We believe there is already momentum in the field, but it would be helpful to have clear milestones supported by close and constructive engagement with the LSB. A shared project plan encompassing the work of the LSB and the regulators would help the key players in their own roles and in supporting each other's participation. Coupled with the role to be undertaken by the ABS Implementation Group and the input of the various reference groups involved, we believe this will drive the project forward.

6. For individual regulators, a key issue will be ensuring that sufficient resources are in place to undertake the work.

7. The LSB acknowledges that sustained and co-ordinated action will be needed from the key players to realise the potential benefits to consumers of ABS as soon as possible. We look forward to working with the LSB to set priorities.

Question 3 – What are your views on whether the LSB should be prepared to license ABS directly in 2011 if necessary to ensure that consumers have access to new ways of delivering legal services?

8. The Act enables the LSB itself to be designated as an approved regulator – ensuring that the consumer benefits of licensed bodies are realised in the event that it appears unlikely to be achieved by any other means. We agree the prudence of being prepared to do so if necessary, but expect to be able to satisfy the LSB that it will not be necessary. The LSB should not have concerns about the will or ability of regulators to achieve ABS – the CLC has for some time had a framework of regulation that permits outside ownership of its regulated bodies, the SRA (which regulates all of the reserved legal activities) implemented the first stage of the changes under the Act in introducing LDPs on schedule, and is working on the developments necessary for ABS. Other regulators are likely to follow suit, although perhaps on a different timescale. [We agree with the concerns expressed in paragraph 2.8 of the need to license bodies where there is no other competent licensing authority to do so and will be considering as part of our work the possibility of developing a framework that will enable us to license such bodies even if they do not contain a solicitor or a registered European lawyer.]

9. An additional factor to consider is the funding of the development work for ABS – this will inevitably fall to the legal profession (not all of whom will wish to take advantage of the changes). There may be concerns about additional increases in the cost of regulation in having to fund not only the development work of a regulator to become a licensing authority but also the same work by the LSB. Regulatory costs are ultimately borne by consumers.

Question 4 - How should the LSB comply with the requirement for appropriate organisational and financial separation of its licensing activities from its other activities?

10. Clearly there must be organisational and financial separation. However, we find it difficult to comment in any detail on this and we refer to our comments to question 3 above. We hope that the LSB will not feel it necessary to apply for its own designation as a licensing authority. This would be an additional burden that might confuse the strategic drive and purpose of the LSB, and diminish the financial and human resources of the LSB available to work in conjunction with the other regulators on the ABS project.

11. Organisational and financial separation of its licensing activities from its other activities will be required to establish a level playing field and so maintain confidence in the LSB as a regulator of regulators. Equally, the licensing arm must be self-financing in the same way as are the other regulators.

The benefits of opening the markets

Question 5 - How do you expect the legal services market to respond and change as a result of opening the market to ABS?

12. The legal services market is already one that is mixed and diverse and there are likely to be varying impacts on different sectors of the market. We have no doubt that competition from new types of providers will have significant impact on traditional law

firms. However, solicitors are experienced at adapting to changes in their market. In the past, for example, firms were quick to modernise their structures once the restriction permitting a maximum of twenty partners was lifted, leading to the growth of international firms which are world leaders in providing legal services.

13. There have been significant indications that the legal services market is ready to respond in a huge variety of ways to the needs of all sorts of consumers once the regulatory framework has been liberalised. No doubt those wishing to continue to practise will be able to respond and adapt, although we believe the reality is that some will find their existing business models unviable. As well as private practice firms, this might include, for example, some not-for-profit bodies where the opening of the market allows funders, such as the Legal Services Commission, to contract instead with purely commercial bodies, perhaps offering greater efficiencies.

Question 6 - In what ways might consumers of all types – including private individuals, small businesses and large companies – benefit from new providers and ways of delivering legal services?

14. We agree that the legal services market place should be driven by the needs and preferences of consumers. The question is how do regulators and firms facilitate new ways of providing services whilst adequately protecting the public interest. It is certainly expected that consumers will reap benefits from the development of ABS – particularly convenience and greater accessibility through a wider choice of types of, and approaches by, providers and reduced cost through an increase in competition. The potential benefits have been discussed throughout the process that resulted in the LSA – these are expected to include greater access to capital, opportunities for further technological innovation as a means of service delivery, combining skills and expertise from a number of professions, the "one-stop shop" and so on.

15. Experience of different types of development in the legal services market has illustrated that there could be disadvantages as well as consumer benefits. For example, the field of personal injury has seen the advent of claims management companies which identified the existence of potential advantages to consumers, as well as to themselves. It is argued that consumers have benefited through easier access to legal services, but some would say that this is at a greater overall cost to the public in an increased level of costs per claim coupled with a consequent increase in insurance premiums to cover the funding and payment of those claims.

16. There is an expectation that ABS will result in an increase in numbers of consumers accessing legal services. The increase in the use of "no win no fee" agreements and referral arrangements has helped clients in getting assistance from firms although it is perhaps worth bearing in mind that few benefits come without a cost. Some argue that firms are less likely to accept cases where the chance of success appears marginal which takes benefit out of the litigation process for claimants and therefore is working against the public interest. Likewise that referral arrangements are regarded by some as a distorting the claims market, but both have helped lawyers' ability to access a steady volume of work. This can lead to greater investment in IT with the benefits of economies of scale, and therefore to an overall reduction in costs to consumers.

17. These are matters very much for debate and we draw no conclusions. However, the opportunities for benefits to consumers must be placed uppermost. In the area of publicly funded work there may be considerable opportunities presented by ABS for efficiencies leading to a greater level of service delivery to consumers at the same cost to the taxpayer. Centralised administration of publicly funded work could offer benefits for practices as well as consumers and the public interest through a "hub and spoke"

model. Individual practitioners and firms could continue to provide specialist legal services but with links to a larger ABS body with systems to deal with the necessary administration work of complying with the funder's requirements.

18. A particular concern in progressing the work is trying to ensure that no model will be accidentally disallowed or overlooked as regulators develop a framework for ABS, and we hope that the views and input from all stakeholders will be of benefit in this.

Question 7 - What opportunities and challenges might arise for law firms, individual lawyers, in-house lawyers and non-lawyer employees of law firms as a result of ABS?

19. With the introduction of LDPs in March, SRA-regulated firms have been able to take advantage of the first new form of practice enabled by the LSA. ABS will go further to remove historic barriers previously imposed by statute, offering firms such new opportunities as joint ownership with non-legal professionals, expanding the services available to clients, taking advantage of external investment and financial support from a range of investors extending from venture capitalists to family members, becoming a franchisee, floating on the stock exchange and taking advantage of the ability to sell the whole business to a non-lawyer organisation.

20. Perhaps the major challenge to firms is the significant change from working in a known and clearly defined legal services market to one with an access route for much more global, all encompassing and product-related service organisations to come in. In effect, a change of dynamics from a fixed/known environment to one where the nature of competition is unknown but based in much larger organisations with considerable resources and efficient cost models. Consumers may feel more comfortable seeking help from a familiar household name (such as a supermarket or motoring organisation), and such providers may well "cherry pick" profitable areas of service and provide benefits to consumers through economies of scale. Existing firms may need to move more into the niche service model where large providers cannot compete – where depth of knowledge and expertise and quality of service are the key selling points and competitive features that distinguish the firm.

21. Firms practising in the international arena and wishing to innovate will face particular challenges in establishing a satisfactory ABS model to navigate the considerable number of jurisdictions in which multi-disciplinary practice remains unlawful.

22. Individual lawyers will have the advantage of a much wider variety of models through which to practise, whether as owners, managers or employees and whether in traditional or new forms of practice. Recent surveys suggest that younger solicitors are less interested in traditional career structures culminating in partnership but are more interested in quality of life. Non-lawyers likewise will have similar opportunities, subject to appropriate approval. Even if individuals do not change, their employment opportunities not previously available would be opened up, such as taking advantage of employee share schemes, and greater opportunities in career progression including greater rights of ownership and control in ABS.

23. The role of in-house solicitors will continue and for some will remain unchanged. However, there will also be increased opportunities for lawyers working in-house and for the employer body. ABS admits the possibility of a blurring of public/private practice. For example, local authority legal departments (subject to any statutory constraints) wanting to sell their services more widely could apply to become regulated as ABS to supply services to a wider range of clients whilst their lawyers remain employees, providing income generation for the employer.

Question 8 - What impact do you think ABS could have on the diversity of the legal profession?

24. There is a high level of representation of BME groupings within the solicitors' profession, although, for a number of reasons, a disproportionate number of individual lawyers are based in smaller firms. For example, in 2009 minority ethnic group solicitors accounted for 10% of all solicitors with practising certificates, and 9.5% of all solicitors in private practice. However, 47% of minority ethnic solicitors were at that time employed as sole practitioners or in 2-4 partner firms, compared with 27% of white European solicitors. ABS is likely to have a greater impact (through competition for market share) on smaller firms and possibly therefore on BME firms. We believe, however, that ABS may also offer new opportunities to BME members of the legal profession. Traditionally such practitioners are believed to have found it easier to secure in-house positions – an area expected to benefit from ABS. Recent statistics show that approximately 10% of those working in-house were within BME groupings, although an additional 14% were categorised as ethnicity unknown, so the figure may be considerably higher.

25. There is a similarly high representation of women in the solicitors' profession – in 2008 44% of practising solicitors were women (although the percentage is higher below the age of 35 years). Women are more likely to be employed than to practise as managers in a firm. In 2008, women made up 42% of solicitors in private practice but only 22% of them were partners (compared with men where 50% of those in private practice were partners). At that time, 51% of in-house solicitors were women. As ABS are expected to increase the availability, and type of, in-house work, women may find greater opportunities open to them.

26. A significant benefit of ABS will be far greater ability for firms to access capital from a wide range of institutions, as well as the opportunity, for example, for family or community members to fund and invest in practices. ABS we believe will give rise to the opportunity for, say, multi-disciplinary practices with funding from personal sources serving the needs of specific communities.

Question 9 - What are the educational and developmental implications of ABS and what actions need to be taken to address them?

27. A range of issues will need to be considered, although many of them are common to the move towards a more firm based form of regulation and are not unique to ABSs. Developmental requirements will need to ensure that ABS managers understand fully the nature and extent of their role in respect of the legal services provided – in particular, their duties in relation to clients in contrast to shareholders/owners. The framework should ensure that there is a clear set of requirements on HoLPs and HoFAs, who will have responsibilities for ensuring appropriate prioritising of interests in practice, and that this is complemented and underpinned by requirements in relation to the collective competence of the managers as a whole. We believe that the means to achieve this end should be flexible to accommodate the wide variety of ABS that is likely to exist. Prescription is better avoided if possible, as is reliance on a requirement for additional compulsory training or qualifications. For example, the need to protect consumers in a three-partner specialist ABS is likely to be very different from that in a national provider offering a suite of services and products. But it will be critical that HoLPs and HoFAs can demonstrate appropriate experience and competence to bring about proper compliance with SRA requirements by all members of staff in the firm, and display the necessary openness with the SRA as regulator. We shall consider whether all HoLPs and HoFAs will need to demonstrate minimum experience and or qualifications/training obtained.

28. From the perspective of individual lawyers, a new emphasis may be called for in post qualification training for lawyers and in continuing professional development. It will need to take account of the move to firm-based regulation and ABS, and also cover new opportunities and career structures for lawyers in broader roles, such as that of HoFA. This is equally the case for non-lawyers aiming for a career in the legal services environment. In particular the SRA is considering placing a new duty on firms/HoLPs to ensure that all staff undertake the CPD necessary to maintain their competence in the areas of law in which they practise, and in some areas of law (especially those where clients lack the knowledge to make independent judgements of the quality of service they receive, or are otherwise vulnerable) we may want to require that practitioners are supervised effectively by one or more lawyers accredited in the area of law in question. Please refer to our current consultation paper "An Agenda for Quality" (www.sra.org.uk/sra/consultations/2808.article) on new ways to maintain and improve the standard of quality of legal services provided by solicitors and firms in which they practice. Our aim at this stage is to produce clear, targeted standards for a range of post-qualification roles (possibly to include HoLPs), as well as a regulatory framework for ensuring these standards are met and maintained. A full, formal consultation will follow development on our proposals - this is planned for 2010. These changes, if adopted, would apply to all law firms, not just to ABSs.

Question 10 - Could fewer restrictions on the management, ownership and financing of legal firms change the impact upon the legal services sector of future economic downturns?

29. Solicitors are familiar with, and experienced in, adapting to market changes, such as broadening their fields of work and outsourcing some functions. ABS will offer them a greater range of options and enhance their opportunities for innovation. It might also be that the risk of further recession could encourage the early development by external owners of ABS firms with the scope to offer a wider range of legal and non-legal services and which therefore have a resilience to market forces.

Managing the risks of opening the market

Question 11 - What are the key risks to the regulatory objectives associated with opening the market to ABS and how are they best mitigated?

30. We agree that many of the risks identified can be found in relation to existing legal practices and that additional regulatory restrictions should be placed on ABS only if there is a compelling case to do so. Risks that exist now will perhaps change in emphasis, but the core concerns remain largely the same. For example, solicitors can be and have been shown to be tempted to disregard the best interests of their clients – for example in the recent miners' compensation cases. Regulators need to be aware of and deal with such threats to consumers' interests in whatever quarter.

31. The SRA regulates a wide range of business types and a broad spectrum of work. Whilst ABS will give rise to novel structures and combinations of approach to service provision, we believe that proportionality will require regulators to apply, as far as possible, consistent standards to all their regulated legal businesses, including having recourse to consistent disciplinary powers. The Act is premised on the creation of a level playing field to promote competition and we believe this must also mean equivalence of regulation, varying only to the extent needed to properly protect clients and the public interest.

32. The risks have been debated widely since the Clementi report, and have been considered at length by Parliament. We believe that all risks we are aware of have been discussed and much work has been done to cater for them in the Act. – some of our major concerns relate to the holding of client money, conflicts of interest, money laundering, and solvency (including that of a large financial institution owning an ABS). It is widely acknowledged that, with the external ownership of firms, there will be a considerably higher risk of ill-intentioned and improper ownership of, or influence over, firms – for example "Al-Qaeda Law" using the firm as a tool for nefarious activities – and this is a concern for all regulators. Again, this is a recognised risk and additional provisions were included in the Act, for example through requirements on regulators to undertake fit and proper tests, but for regulators identifying and preventing this type of risk, and more so dealing with identified cases, will represent a highly challenging task.

33. There is considerable, and realistic, concern in relation to the risk of fraud through ABS. This is an existing threat that regulators have to address – the SRA perhaps particularly so because of the very large amounts of client money passing through solicitors' client accounts each year. The risks associated with holding client money are far-reaching as they can arise in relation not only to reserved but also to non-reserved activities, such as the administration of estates or company takeover work. A significant difference in the vulnerability of ABS to such risks is the very much more compressed period it would take to achieve control of an ABS than it currently does to attain a legal qualification and enter a profession enabling someone to gain control of a legal practice.

34. There may also be more direct risks to consumers in ABS, for example the pressure to buy other services and for information-sharing, if the business has other products to sell. There will be benefits to be had by consumers but the vital requirement will be that firms are transparent and open – clients will need to be given an **understanding** of any risks and what may be inappropriate for them. Although regulation is in place, incentives such as cross-selling profitable products when not necessarily in consumers' interests must be borne in mind. This will be a cultural issue as much as a regulatory one for firms. We suspect that lessons can be learnt from the FSA and its work following the exposure of endowment and pension mis-selling.

35. Consumers' interests would also be at risk from the insolvency of ABS. Current firms can and do "go under" and there are mechanisms to lessen as far as possible the impact on clients with ongoing matters. However, more complex structures may present an increased level of risk in practical terms – dealing with an insolvent national body with perhaps thousands of clients and holding possibly £millions of client money would surely be a significant undertaking for any regulator.

Question 12 - Are there particular types of business structure or model which you consider to present a particular risk to the regulatory objectives?

36. This is difficult to predict and we look forward to seeing the responses to this question – we raise a range of issues on this topic in our own discussion paper (see paragraph 2 above) and hope that this too will add to the debate. Our starting point is that we should avoid proscribing particular structures or models, unless there is very clear evidence of a significant risk.

37. An obvious answer is clearly where an absolute conflict exists, for example where there is an adverse interest in relation to the provision of legal services between those that the business (in its widest context) wants to serve, such as having a role in relation to both sides of a litigation matter perhaps. In less general terms, a specific example of a model with difficulties would be one involving solicitors and accountants where there is a clash of regulatory obligations in relation to confidentially for solicitors but disclosure in

audit work for accountants. This type of situation, and perhaps others not yet identified, will restrict firms' freedom to establish the business they may wish, and require tactics such as ring-fencing parts of the business to achieve the ABS objective.

38. Again, where very large, complex structures are set up, the risk of insolvency (although unlikely) could lead to considerable difficulties, not only for clients, but for the regulator too in both practical and financial terms.

Question 13 - What conflicts of interest do you think might arise in relation to ABSs and how should they be managed?

39. It is important to categorise the range of conflicts which might occur – these may be between the interests of individual clients/consumers (as now); adverse interests between parts of the business (e.g. a legal practice and auditor's practice); and commercial conflicts within the business (e.g. shareholders and consumers).

40. We agree it will be beneficial to consider establishing a hierarchy of duties to deal with conflicts. Although there are safeguards, for example the Act prevents shareholders encouraging breach of the regulatory objective in acting for clients, we think it would be helpful for players at all levels for the LSB to provide transparency by rule/standard confirming that duties to clients "trump" duties to shareholders (similar to the Australian model referred to in the paper). This will also go to creating/supporting a culture within ABS of recognising and prioritising differing interests/goals when some players will have existed previously in areas where the business imperative is very different.

41. The approach of individual regulators might be to identify those conflicts which are "intrinsic" in the nature of the particular ABS, and those which are not. The SRA believes that most could be dealt with by our rules although it may necessary to apply additional specific requirements to an ABS if this needed for the protection of consumers. Flexibility coupled with general standards on all firms will ensure tailoring of the regulatory approach to address specific needs and circumstances in an area where there can be a range of conflict factors at play.

42. An example which has been mooted is the involvement of a legal expenses insurer ("LEI") in an ABS undertaking litigation funded by the LEI – is this a conflict or a manageable risk? We believe such a business should not be prevented but that it would be fixed with responsibility to make clear to consumers at the point of sale both any perceived risk, and what duties are owed by the legal services provider. For the goals of the Act to be realised as intended, consumers should be able to enter such arrangements but will need to understand that their relationship with their lawyer is in the context of legal proceedings only – and should not be tied into non-transparent arrangements. It will no doubt be helpful to refer to the European Directive on legal expenses insurance and freedom of choice.

43. Solicitors' firms hold very considerable amounts of client money and this facility alone could raise issues of conflict. Banking institutions, for example, involved in ABS will have their own particular challenges. A law firm owned by a bank would need specific client protections – a client may have loans, guarantees, mortgage arrangements and so on with the bank and arrangements would need to protect client money from being used for other interests of the bank. In the same way, the sharing of confidential information would be an issue to be addressed.

44. Lessons might perhaps be learnt from the FSA and its approach. Market changes, such as mergers of business, led to an erosion of the distinction the FSA had required between IFAs and tied agents – the FSA now requires greater openness and

transparency in the information and advice to be given when selling products. It is worth noting however that there continues to be debate whether overall this is a beneficial development – although the service may be cheaper and provide the advice needed, has there been an undesirable lessening of valuable client protections. The current FSA discussion paper which is a review of retail distribution will be of interest.

Risk-based regulation of entities

Question 14 - How should licensing authorities approach entity-based regulation and what are the main differences from the traditional focus on regulating individuals?

45. The SRA began introducing entity-based regulation from 1 January 1992 when solicitors were first permitted to practise in corporate form, although in practice this was more of a recognition regime than real entity-based regulation. It was clear that in order to deliver the objectives of the LSA, the implementation of new forms of regulation, based on the firm rather than the individual solicitor would be required and our entity-based approach was extended on 31 March 2009 to apply to all partnerships, including LDPs, and from 1 July to all sole practitioners. We regard it as a vital part of the development of LDPs to enable us to license the practising vehicles themselves and to apply our full regulatory and disciplinary powers to all players in firms, including non-lawyer managers and employees. It will be an equally important aspect of our approach to ABS regulation.

46. We are alive to the fact that ABS regulation will require further development of our basic framework for regulating entities. Greater emphasis will be needed on system level issues such as audit, risk management and ensuring the robustness of firms' internal governance arrangements to provide proper control of varied and sophisticated structures.

Question 15 - Do you agree with our view that licensing authorities should take a risk-based approach to regulation of ABS, and if so, how might this work in practice?

47. We agree with the proposition that a risk-based approach is appropriate to the regulation of ABS. The SRA is currently developing its regulatory systems with an emphasis on targeting resources at dealing with serious risk. The underlying aim is to reduce the overall regulatory burden by encouraging self-regulation where firms are able to demonstrate that they have strong consumer safeguards and effective systems in place for managing risk.

48. We believe that the same ethical standards and consumer protections should apply to all bodies (whether traditional firms or ABS) serving consumers, with additional and proportionate regulatory requirements where justified by an identified risk. Likewise, the same risk-based approach to the regulation of all bodies will provide consistency and equality between those in the regulated community.

Question 16 - What is your preferred balance in regulating ABS between a focus on high-level principles and outcomes and a more prescriptive approach?

49. It is said that principle-based regulation needs people with principles – the recent developments in the banking world have given ample food for consideration of this. Our preference is for an emphasis on high-level principles and outcomes (which can be more accessible to clients), with sufficient non-mandatory guidance to allow flexibility in different situations/organisations and to ensure that compliance can be achieved. We think this will be linked closely to governance issues and the need to create a culture of regulatory compliance (alongside commercial interests) embedding regulatory principles

in the leadership of organisations, in which we believe the development of entity-based regulation, will be key. Fully achieving this regulatory balance is unlikely to be accomplished by mid-2011 – the experience of regulators in actually regulating ABS, including novel firms such as MDPs and wholly non-lawyer owned firms, will be an important factor in the work to develop a regime that is both appropriate and effective to all firms we regulate. We are conscious that this may well include a majority of firms which are not ABS.

50. For some areas of regulation a high level approach needs to be supported by specific rules. For example, the protection of client money is vital for consumers and some more detailed provisions are required - the SRA's accounts rules ensure the statutory protection of client money under section 85 of the Solicitors Act. Equally, they enable other such as accountants to have proper oversight of solicitors' accounts when they are working under other rules and different cultural assumptions.

Question 17 - What are the advantages and disadvantages of a requirement on ABS to have a majority of lawyer managers?

51. We do not see the necessity of a general requirement for a majority of lawyer managers in ABS, and believe this is not in keeping with the liberalisation of legal services upon which the Act is predicated. There is a view that an evolutionary approach may lessen risks to the public interest whilst lessons can be learned – we do not subscribe to this view because we feel that setting stringent limits in the early days of innovation risks stifling the development of a broader range of service providers.

52. It will be possible to attach licence conditions in high risk cases (although we think these will be limited) for example, a ring-fenced subsidiary of an insurance company might need a majority of lawyers on the board where there are identifiable risks of conflict that cannot be "treated" by other regulatory means. The requirement for an ABS to appoint HoLPs and HoFAs is intended to provide other means to manage such perceived risks and regulators should look to these protections as a first stage regulation tool.

53. Although regulators have adequate powers for regulation and discipline of both organisations and individuals within them, in some instances practical issues may dictate that additional conditions are necessary – if a large ABS might otherwise have only one lawyer manager, a requirement for more may be reasonable in protecting consumers' interests, if only to deal with normal absences.

Question 18 - What are your views about how licensing authorities should determine whether a person is a "fit and proper person" to carry out their duties as a HoLP or a HoFA?

54. We believe the approach to determining individuals' suitability should be a risk-based one, using a combination of existing fitness and properness criteria (including for current non-lawyer managers), and should focus on honesty, integrity, financial soundness and competence for the role (including requirements in relation to training and experience).

55. The approach to assessment of HoLPs ad HoFAs could be bolstered by a mandatory list of accountabilities in the job description for the role (re-emphasising the statutory whistle-blowing requirement). A significant question will be the level at which they need to sit – do the responsibilities of the HoLP and HoFA mean the roles should be fulfilled only by managers of the ABS? Governance arrangements which maintain the collective responsibility of all managers will also be crucial, but we believe it will be important in both the reality and perception of consumer protections to ensure that these responsibilities sit at an appropriately high level.

56. The HoLP must be a lawyer, but should the HoFA also be a lawyer? The proper protection of the public interest and consumers will demand that the role of the HoLP is fulfilled a lawyer of appropriate experience. In contrast, we believe it is unlikely to be necessary for a HoFA to be a lawyer, or perhaps even an accountant.

57. Effective regulatory systems will require that firms appoint a HoFA with particular and appropriate experience in the context of their firm, and providing evidence for the regulator to assess this. One model may be, for example, a small family firm, possibly reliant on family funding – would it be proportionate to require a HoFA who is an accountant of 10 years' experience? In the case of a large ABS providing national coverage, wholly different experience and qualities would be needed so flexibility for regulators will be crucial in approaching this.

Question 19 - What is the right balance between rejecting "higher-risk" licensing applications and developing systems to monitor compliance by higher-risk licensed bodies?

58. There is a strong consumer/public protection balance in favour of determining any application correctly initially – no reasonable regulator will wish to rely on the ability to close a firm as a "second-tier" decision-making process. Refusal must be the only option/approach in applications where the risk cannot be addressed (for example ABS owners with criminal connections). For regulators, developing systems to identify these will be imperative and the burden of proof must be placed on applicants to demonstrate suitability.

59. Whether or not firms are regarded as improper initially, it is both difficult and costly to close them down and the LSB and all the regulators must not lose sight of this. Closing a law practice has a major impact on consumers. If, for example, a firm selling insurance closes the effects tend to be only on those needing insurance renewal at the time of closure. A firm providing legal services is likely to have large numbers of ongoing client matters, which can last for many years. It will hold the files, assets, money and so on of current clients and former clients and the impact is inevitably far reaching.

Question 20 - How should regulators ensure a level playing-field between regulated legal practices and licensed bodies?

60. Our view is that it is very important that consumers can be confident that all organisations that we regulate are subject to the same ethical and service standards and the same consumer protections. We believe that this facilitates proper competition dovetails with the need for a level playing-field, and provides clarity for the consumer.

Specific regulatory issues

Question 21 - How should licensing authorities approach the access to justice condition, and do you agree that it is unlikely that many licences should be rejected on the basis of the condition?

61. We agree that rejection on this basis should be very unlikely, particularly in view of the requirement to promote competition in the sector. Debate continues as to what is meant by access to justice and, in light of this, it is difficult to see how regulators can be sure of complying with the regulatory objective. A policy steer from the LSB on dealing with the

condition would assist regulators, as would input and support from bodies such as the OFT and the Competition Commission which have great experience in this area.

62. The SRA expects the onus will be placed on applicants to demonstrate how they meet the condition, where necessary. We believe we will be able to license most firms on an assumption that access to justice can be demonstrated, for example small and medium mixed practices entering the market. Equally, it would appear unreasonable to expect firms making small changes, such as becoming an ABS on taking in a non-lawyer manager, to have to justify the change. The area likely to call for the greatest consideration is the entry into the market of large scale players such as supermarkets in the case of privately funded work, and large mixed-service providers such as Capita in the publicly funded field. Both, it is thought, could lead to a decline in the network of firms and cause access to justice to suffer in rural and remote areas. In this type of case it is likely to be appropriate for regulators to require such players to demonstrate how the regulatory objective would be satisfied – perhaps by way of a requirement to produce an independent impact assessment in cases where the potential impact appears to be wide.

63. The LSC has long had a particular role in ensuring funding is available in appropriate cases to those who would not otherwise get access to justice. The regulators' own obligation in respect of access to justice will change the emphasis and means they need to be proactive and make their own assessments. For example, if a larger supermarket were to apply for a licence it would need to be taken into account if the impact of that in some areas may be the closure of firms providing a service(s) which would then be unavailable, particularly so if this involved the types of service generally and provided to disadvantaged clients under public funding.

64. The SRA would welcome thresholds being set by the LSB to establish when more information/justification on the question of access to justice should be sought – in effect to draw a line in the sand for regulators to work from. We believe the regulatory objectives are best served by use of such a base line coupled with top-end discretion for regulators in addressing and dealing with specific risks exposed on an individual basis. Equality of approach with flexibility built in will facilitate proper judgement on access to justice questions and reassure the public interest.

Question 22 - How should licensing authorities give effect to indemnification and compensation arrangements for ABS?

65. Although the Act provides for a number of options in the application of these public protections, we believe that the SRA's current arrangements provide consumers with unrivalled protection and we hope to apply the same standards to all organisations we regulate, including ABS. To pare them back, we believe, would not be in the public interest. If ABS were permitted to function with lesser protections than those in traditional firms, not only would consumers be disadvantaged but there would be a distortion of the level playing field. We do not believe the fact of external ownership by "fit and proper" non-authorised persons should lead to insurers viewing the risk of civil claims against an ABS being very different from the risk in traditional solicitors' firms. We would welcome the views of the insurers on this area generally.

66. Although compensation fund claims, which cover dishonesty, may occur less in ABS (such claims in larger organisations more commonly fall to insurers), there is no doubt that they will remain a possibility. We would want similar levels of client protection whatever the nature and ownership of the body – our own discussion paper (see paragraph 2 above) considers these issues from the SRA perspective in more detail.

Question 23 - How should complaints-handling in relation to legal services provided by ABS be regulated?

67. We agree that there would need to be strong evidence for significant differentiation in the arrangements for complaints handling specified for ABS from those specified for the non-ABS environment. As with existing firms, we expect that consumer complaints against ABS will in future be dealt with by the OLC, having first been considered by the firm, and that there will be dovetailing with the systems of other interested regulators, such as the FSA – we see no reason for this to be altered for ABS. In respect of conduct issues, our intention is to apply, as far as possible, the same complaints-handling requirements and disciplinary measures to ABS as to traditional firms. SRA rules currently apply to all managers and employees of firms as well as to recognised bodies, including LDPs with non-lawyer managers and owners. The reality is that LDPs are in their very early stages and we have little actual experience to call on in the application of our rules and procedures to non-lawyers – this is something that we expect will offer greater insight over time.

Question 24 - How should licensing authorities approach the "fit to own" test and how critical is it in mitigating the risk to the regulatory objective of promoting lawyers' adherence to their professional principles?

68. The SRA regards this as vital in protecting the public and as critical in mitigating risk to all of the regulatory objectives. Equally, we believe that Parliament saw the "fit to own" test as a critical part of mitigating the risk that might be presented by some types of ABS. It will be one of the key factors which, along with proper governance arrangements in firms and effective requirements in relation to the roles of HOFAs and HOLPs, will establish the fundamentals of good practice in ABS.

69. We believe it important to develop a system which is capable of both identifying those in ultimate control of the business as well as assuring us of their proper identity – perhaps along the lines of the FSA's approach. The best tests are worthless if not directed at the right person or body. Assessment itself we believe must look at probity and financial position as well as integrity and competence where applicable. This is backed by the provisions in the Act.

70. The essential principle is that if individuals or bodies are not fit to own they should not be allowed to own any part of an ABS. The goal for regulators will be to establish tests that avoid mis-assessments. There may be questions about aptness to own which can be dealt with otherwise – for example if an individual exhibits a history of non-compliance with regulatory standards the HoLP and perhaps the HoFA will perhaps be the appropriate means to deal with the identified risk. In contrast, an individual with a criminal offence in their past may well be viewed differently. It is important to remember that the fit to own test is the gateway to prevent entry by the "un-policable". Those fulfilling the roles of HoLP and HoFA should expect to manage the general commercial pressures of the business but not to bear the burden of protecting consumers by endeavouring to control that which is fundamentally flawed.

Question 25 - Are there are any particular risks to the regulatory objectives that could arise from ABS offering non-reserved legal services?

71. Our concern is not that all non-reserved services should be subject to a regulatory regime, we expect for example that an independent will-making company would continue as now. The unease we have is that an ABS could provide the reserved part of its service through a regulated body, whilst clients receive the non-reserved part of the service, even where this is in the "same" matter such as the pre-litigation work on a

claim file, through a separate and unregulated business. Avoiding the cost and trappings of regulation may well encourage businesses to separate services, but would this be in consumers' interests? The risk is that consumers may not understand that they have the benefit of a raft of protections covering one part of the service but not another[– even if consumers understand the separation, is it generally in consumers' interests for it to be possible to have an "artificial" splitting of matters in this way? In addition, the ability of some players and not others to capsulise their service will undermine the objective of competition in the market].

72. We are very interested to hear others' input on this subject. Our view is that there are significant problems in terms of "regulatory reach", clarity for consumers, and the "level playing field" that may arise from treating reserved and non-reserved work differently. With the Consumer Panel's work on the scope of reserved activities it would be helpful to include research into consumer expectations of regulation if an ABS hived off non-reserved work.

73. We do not believe that there are particular risks to the regulatory objectives from ABS offering non-reserved legal services – rather that clients will benefit from the additional protections of regulation in respect of the non-reserved work. The vast majority of solicitors' firms provide a mix of reserved and non-reserved services to clients and we expect that this will be equally true of ABS. Solicitors firms are fully regulated (including all individuals within them) and solicitors are not permitted to provide non-reserved services through a separate, unregulated vehicle because of the lack of the normal client protections. Our view is that the consumer interest is best served by continuing with this approach which offers clients consistency and the best protections available. For the same reasons we favour having a rule that solicitors could only provide services to the public as solicitors through a fully regulated business, whether traditional law firm or ABS.

Special bodies

Question 26 - What are the risks to the consumer associated with the delivery of legal services by special bodies and which more general risks are less relevant to these bodies?

74. The SRA believes that special bodies should be brought into the regulatory regime and regulated as entities. Such bodies commonly provide legal services to consumers who are disadvantaged and who need to be covered by the full consumer protections available. Although the not for profit sector is generally regarded as low risk, we have experience of complaints against them, including an example of a Law Centre solicitor taking client money. Such cases highlight the difficulty of providing consumer redress where the centre's solicitor was neither responsible for the advice on a client's matter nor for its supervision. It would be far better in offering equality of protections for consumers if special bodies, along with other licensed bodies, could be regulated in future in the same way as recognised bodies.

75. The general risks associated with ABS such as conflicts and commercial pressures are likely to be less relevant in special bodies, although the recent problems in relation to miners' compensation demonstrate that such bodies are not exempt from pressures and consequent risks to clients. For this reason the SRA remains opposed to the Trade Union exemption when providing services to members.

76. Referring back to paragraph 7 above, as the timetable for the abolition of the transitional exemption for these bodies allows for them to be dealt with later than other ABS. The

SRA believes the LSB should concentrate its resources for the time being on developing the framework for “mainstream” ABS and, as these bodies are acknowledged to present a lower risk for consumers, to deal with this area of work later, perhaps in 2012.

Question 27 - Is it in the consumer interest to require special bodies to seek a licence, and if so, what broad approach should licensing authorities take to their regulation?

77. Whilst we believe consumer interests call for special bodies to be brought within the licensing regime and regulated as entities, we support an approach which allows licensing authorities to have a light regulatory touch, acknowledging the differing risks associated with such bodies and to lessen the costs in monetary and manpower terms. We would welcome the opportunity to explore with the LSB the possibility of a group licence approach for all members of specified groups, such as CABs and Law Centres, to lessen the administrative burden for bodies in obtaining and maintaining a licence.

Question 28 - Are there any other issues that you would like to raise in respect of ABS that has not been covered by previous questions?

78. We are conscious in formulating our response that the definition of consumers in the Act is very wide and covers a broader range of individuals and bodies than the lawyer’s own client, which will have a consequent impact on the obligations of regulators in protecting and promoting the interests of consumers in relation to ABS.

79. We are very interested to hear the views of other stakeholders on the matters raised in this paper.