Consultation response

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Wider Access, Better Value, Strong Protection

Submission by Which?

INTRODUCTION

Which? is an independent, not-for-profit consumer organisation with around 700,000 members and is the largest consumer organisation in Europe. Which? is independent of Government and industry, and is funded through the sale of Which? consumer magazines, and books.

We are also a provider of legal services through Which? Legal Service, offering consumer advice to subscribers. A basic subscription to Which? Legal Service costs from £31 per annum for Which? members to £85 per annum for Which? Legal Service Plus for advice by email and telephone. The service is regulated by the Solicitors Regulation Authority. http://www.whichlegalservice.co.uk/home.aspx

A) GENERAL COMMENTS

Thank you for this opportunity to respond to this important consultation. We are very supportive of the work that the Legal Services Board is doing to create the possibility of lawyers and non-lawyers going into business together to develop integrated legal solutions, eradicating the current restrictions on non-lawyers participating in the ownership of law firms.

We consider this liberalisation to be firmly in the interests of consumers. The foundations were laid when Parliament passed the Legal Services Act in 2007 following the Clementi Review and now it's the job of the Legal Services Board (LSB) to make it happen.

The effect of opening up the market to ABS has been described by critics as the introduction of "Tesco-law". Whilst it is possible that one of the big brands may pick up on the opportunities afforded by the liberalisation of the market, that is just one possible model for ABS; opening up the legal market might well lead to the evolution of legal models that we could not have predicted as the following quote suggests:

> *"Competition delivers results in ways that government bureaucrats cannot anticipate. Consumers can expect more choice, innovative services and lower prices. Familiar brands such as Tesco and the AA have nothing to gain from offering substandard legal services" (FT: 6th June 2006)*

We would anticipate that ABS will lead to many opportunities for greater efficiencies by, for example, enabling solicitors to join an accountancy practice or a financial adviser. There may also be business models that involve greater provision of advice by telephone and less reliance on face to face meetings, in a similar vein to the way NHS Direct has flourished.

ABS firms should also have increased access to finance with more relaxed rules than at present where legal firms can face constraints on the amount of equity they can raise.

We broadly welcome these potential developments that may deliver greater diversity to the legal professions, producing the economic benefits which will flow from attracting the most talented staff, be they qualified lawyers or not. There is some evidence to suggest that the current legal structures do not provide appropriate incentives nor promote diversity.

If it is to be judged a success, the liberalisation of the market must lead to greater transparency and understanding of legal services, which in turn must lead to improved access to justice, especially for individuals as opposed to large corporate clients.

B) DETAILED RESPONSE TO CONSULTATION QUESTIONS

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?

We welcome the LSB's setting out of the timeline culminating in the objective of granting the first ABS licenses by mid-2011. The precise date is not as important to us as the commitment demonstrated by a timeline made up of clear goals. We would counsel that two factors are outside the control of the LSB; the regulators or licensing bodies will need to have successfully received their designation as licensing authorities, and, in turn, the regulators will need to have approved the first ABS providers.

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

The drive towards ABS will come primarily from service providers seeking to exploit commercial opportunities provided by opening up the market. In addition, the regulators will need to be prepared to approve applications in accordance with the guidelines. In its role as a licensing authority, the LSB will provide leadership and guidance by example setting. It has already begun to do that by setting a clear timeline for approval of the first ABS structures.

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?

We anticipate that current regulators will seek licensing powers and that other organisations which are not currently overseen by the LSB will also seek such powers. However it is still possible that there will be regulatory gaps in the licensing structure where there is no competent licensing authority. In such circumstances the LSB will need to act as a licensing authority itself. It would be inequitable for a potential ABS provider to be hindered in providing services by the fact that they do not have an organisation from which to seek approval. There would also be an adverse effect on competition.

As described above, the LSB may find itself taking a lead in this respect by providing direct licensing before the frontline regulators. We anticipate that the licensing rules developed by the LSB will be important in influencing the regulators' approach to their licensing duties. Therefore this will provide an important opportunity to promote best practice and consistency where possible.

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

Adopting a risk based and proportionate approach, we would anticipate that the LSB should be prepared for formal separation of its licensing function and its other functions in the event of a significant volume of applications.

If it became necessary, the direct licensing role of the LSB would likely justify legal and physical separation as well as accounting separation. This would provide a clear separation between the various functions of the LSB and reduce the risk of a conflict of interest arising. In particular, it will provide an even playing field for other licensing authorities and transparency for potential applicants. The LSB should also consider independent governance and management of its licensing activities and seek to foster a separate identity, culture and branding.

Any steps taken to ensure organisational and financial separation of the LSB's licensing activities from its other activities should be aimed at ensuring that the license monies received by the LSB are used only for this aspect of its business and that it is self financing in this regard.

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

No one can entirely predict the shape of future models for the delivery of legal services. This is both a reason to be excited and a reason to make sure that the regulation can effectively handle anything that the market may throw at it.
The case study of opticians is helpful and we agree that there are analogies with legal services. However there is an important difference; in optical services, the dispensing function was treated separately from the ophthalmic function and deregulated and unqualified sellers were permitted to supply spectacles. Optometry presents greater health risks than dispensing and therefore the regulation of optometry has been reserved. There is no obvious parallel discrete legal service which may be similarly opened up to unqualified ABS staff and a proposal to do so would actually restrict the types of business able to be done by ABS firms.

The joint venture of Specsavers may provide one possible model for an ABS where lawyers provide the technical legal services and ensuring regulatory compliance but the body as a whole can exploit economies of scale in ancillary activities such as marketing and training. The model combines the commercial incentives with incentives to enhance and maintain professional standards. The LSB's role will be facilitative rather than prescriptive and therefore it should aim to provide an

environment which is structurally neutral, one that does not favour one model over another.

A key change relates to access to finance. The current restrictions on the business structures available to lawyers create market imperfections and failure. ABS will increase access to corporate finance in order to permit new types of borrowing and borrowing on a greater scale. Lawyers who operate in ABS will be able to open up previously restricted means of raising finance. Therefore providers of legal services may obtain finance through charges, debentures and the issue of shares.

Regulation currently exists to protect investors and consumers who deal with businesses who borrow in this way - for example, rules governing the maintenance of share capital. Legal services would fall within such rules which would continue to apply. However the opening up of the market will lead to businesses being exposed to greater financial risks and consequently third parties including consumers will need to be given a degree of extra protection to take into account this increased financial risk.

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 developing legal services?

We appreciate the benefits of delivering high quality legal services to all users, from corporate clients of City firms seeking advice on mergers and acquisitions (M&A) to individuals facing criminal proceedings.

To the best of our knowledge, the 'high' end of the City has generally worked well, with well informed clients able to demand the services which they require in a competitive market and for which they can afford to pay.

Our concerns relate to the provision of services to individuals and, to a slightly lesser extent, small businesses. The delivery of legal services to these groups has unique challenges. These consumers will often have little or no knowledge of the service which they are receiving and are not therefore in a position to demand a high standard of service. This also makes it harder for them to effectively shop around between providers.

ABS will allow new providers into the marketplace which will lead, at least in theory, to a reduction in the price of legal services. It should be noted however that in relation to opticians, "the evidence regarding price was inconclusive"[1].
The other key anticipated benefit of ABS should be in terms of the nature of service delivery. In particular, we support innovation in the delivery of legal services for example, by greater provision of advice by telephone and less reliance on face to face meetings.
However consumers should be drivers of such changes and the regulation of ABS must remain neutral and facilitative and not favour one means of delivery over another. We note the experiences in shift towards the provision of legal aid by telephone and health services by NHS direct. One concern is that services provided exclusively by one means, say the internet, will create a potential barrier to access to justice in particular to vulnerable consumers.

The case study of the British Printing Industries Federation where the BPIF has expressed an interest in providing legal services demonstrates how ABS may provide the spur for the provision of specialised niche services rather than a threat to current small providers.

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?

We would anticipate that the removal of restrictions on finance options and management, which apply to existing practices, will lead to opportunities for greater efficiency by enabling solicitors, for example, to join an accountancy practice or a financial adviser.

Whilst there could be many benefits to such changes, one note of caution relates to the potential conflicts of interest which may arise from such arrangements, for example in relation to estate agents who act for sellers and lawyers in the same practice acting for a buyer. There needs to be strong protection put into place so that consumers are well protected in such circumstances.

The introduction of forms of finance in addition to loan finance and capital contributions from partners will change the model of reward in ABS from the traditional salary and equity share of profits. It is important that the incentive structures provided by ABS to staff and directors are appropriate to the nature of

[1] The Benefits from Competition: some illustrative UK cases, DTI Economics Paper No.9 (2004) as quoted in the consultation document

the business and do not encourage excessive risk taking which may threaten consumers, investors and third parties.

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

As suggested in the consultation, there is some evidence to suggest that the current structures do not provide appropriate incentives while promoting diversity. We welcome measures to promote wider access to the professions for reasons of justice and in order to promote diversity of the profession and the economic benefits which will flow from attracting the most talented staff. However, we do not have evidence on exactly how this could happen.

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

We have no comment on this question.

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?

We have no comment on this question.

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

Traditional forms of legal practice are not immune from the risks which are claimed for ABS and we agree that the starting point for the regulation of ABS must be as close as possible to that of existing firms. However there may be some circumstances and some practices which present greater risks and which merit greater regulatory control.

A key new dimension of the introduction of ABS will be to augment financial risks. The traditional business structures of partnerships and chambers with attendant personal liability did limit consumers' financial risks and therefore regulation of lawyers has tended to focus on matters of lawyers' conduct rather than financial stability of the businesses or prudential regulation.

Consumers will not be in a position to judge the financial stability of ABS providers. Any gaps in the protection provided by insurance or compensation funds will need

to be plugged. Failure to protect consumers will lead to a very damaging loss of consumer confidence and consequent damage not only to ABS but to the reputation of legal services providers as a whole.

In relation to the specific risks associated with dealing with client's money we would be concerned if any of the protections which currently apply, for example, the principle under the Solicitors' Account Rules that client money must be kept separately from that of the firm, were to be compromised. The safety of client money is fundamental to consumer confidence in legal services and to the success of ABS. The risk of loss as a result of fraud or poor accounting practices must be minimised.

Opponents of ABS have argued that some of the dangers arise from the involvement of individuals in legal practices who are not lawyers and who are not therefore bound by professional codes of conduct. This risk may be mitigated by the move towards more entity based regulation in addition to the focus on regulating lawyers individually. There will also be a "fitness to own" test applied to all non-lawyer owners (of 10% or more) of ABS.

Of more concern might be the potential for providers to move into the legal services market and unbalance it by "cherry-picking" certain types of work, while leaving less attractive work to be picked up by traditional providers. This might actually reduce consumer choice and access and it would have the potential to put a strain on providers (for example those in the not-for-profit sector) who act as a safety net for consumers.

We are unclear about how increased competition, with the possible entry of large retail brands and the changes in market structure which might follow, would lead to a reduction in access to justice. Many legal services do not require face to face meetings between lawyers and their clients and commoditisation, with lower costs and greater brand recognition, could actually lead to an enhanced access to justice.

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

Barristers have traditionally viewed their status as self employed as essential to their independence, reputation and access to justice in relation to cases where it would be hard to obtain representation. We would question the extent to which those qualities are founded on and exclusive to self-employment, while bearing in mind that ABS will provide opportunities for new ways to deliver legal services alongside the traditional structures. There is no proposal to restrict the services

provided currently at the bar or to impose restrictions on how those services may be provided.

ABS firms may wish to provide a seamless service for clients by employing in-house advocates and the distinction between advocacy and other types of legal services may be eroded as a result. Such a model may be attractive commercially as well as a way of providing the client with the benefit of the advisor with whom they have built a close relationship representing them in court. The debate around a fused legal profession has been going for some years. We are not convinced that consumers' interests are served only by one particular model to the exclusion of others. It appears to us that the restrictions on the way in which lawyers do business have acted against consumers' interests and that they would be better served by accepting that the regulatory objectives may be served in a number of ways.

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

There is potential for unforeseen conflicts of interest to arise when ABS firms are created that did not exist in the context of traditional firms and such cases will present challenges to the current regulation of lawyers. At this stage however such conflicts may be dealt with by extending existing principles in order to deal with the circumstances.

This approach has evolved already and an example may be seen with the relaxation of the rules in 2004 relating to the payment of referral fees by solicitors to third parties, in particular insurers in road traffic accident cases. In such cases, claimants have been referred to personal injury solicitors by their insurance company. In return the solicitors have paid a referral fee to the insurers. There is potential for a conflict of interest where the claimant may be unaware about the fact of the payment and that they have a choice and may appoint their own solicitors if they wish. The rules in relation to this arrangement make it clear that clients must be told about the arrangement, nevertheless the SRA found "widespread infringement of the rules". The problems which arose were not problems with the rules but with their monitoring and enforcement. Following a review of the way in which the rules were operating the SRA decided against an outright ban preferring instead to seek to improve compliance.[2] This should be kept under review.

[2] SRA press release 11 January 2008

Another area for a potential conflict of interest to arise is in the context of an MDP bringing together lawyers and estate agents. Under the Solicitor's Code of Conduct a solicitor may not act for more than one party in conveyancing[3]. A logical extension of this rule might be to prevent a lawyer within an estate agent MDP (where the agent is appointed by the seller) from acting for the buyer. The same would apply in relation to a lease or other property or mortgage transaction.
In short, we agree with the position that "*the approved regulators already have rules in place to manage conflicts of interest within legal firms and we should not assume that the risks of ABS are substantially different from those already found within legal practices*." [4]

We would support a move towards an explicit statement setting out the hierarchy of duties in the event of a conflict of interest between the duties of a lawyer to their company employer or as a director of that company and their duty to their client.

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

The traditional approach of regulating individual lawyers rather than the risks associated with the firm as a whole has focussed on the conduct of the lawyer rather than the impact of the breach of the rules upon the client. This has given rise to an opaque system of regulation and a punitive rather than a redress based regime where regulators have seen their purpose largely limited to disciplining the lawyer and avoiding damage to the reputation of the profession rather than providing redress for consumers. For example the Solicitors' Code of Conduct is a detailed set of rules whose purpose and relevance are difficult for consumers to understand, with a confusing distinction between service and conduct matters. Implementation is reactive and often relies upon a complaint from a consumer or another lawyer.

As a result of the punitive nature of the sanctions and the possibility of disciplinary action, lawyers who were the subject of complaints might be very defensive in their response to complaints and respond as if acting in litigation. The result of this would be a long and drawn out investigation where the regulator's role would be reduced to one of passing on the parties' comments to each other before finally coming to a view. This would often leave the consumer disillusioned and the

[3] Solicitors' Code of Conduct Rule 3

[4] LSB 'Wider Access, Better Value, Strong Protection' consultation document

individual lawyer resentful. (see several reports of the Legal Services Ombudsman passim).

Going forward, we can see the benefits of having an increased focus on entity based regulation – ie focussing on the outcomes for consumers at a corporate level rather than just on the actions of individuals within a company. The traditional approach, with the focus on the conduct of the lawyer rather than the risks to consumers is to some extent unworkable in the context of ABS. The fact that regulators who derive their authority from the qualifications of the lawyer will lack jurisdiction over individuals who do not hold the relevant qualifications means that some regulatory gaps could appear.

A further benefit of an entity based approach would be to dissipate the highly charged and unhelpful personal nature of the exchange between complainants and lawyers. We raised this point in our response to the review of the regulation of legal services by Sir David Clementi.

We also want to see an increased focus on ensuring that redress is available for users. However, it is not a given that regulators will change their attitude and focus on providing redress, rather than the disciplining of individual lawyers. We are concerned therefore that this should also form the basis of change.

Whilst we support this overall shift, we would not take this approach to the other extreme. It will still be important to maintain high standards of practice by individual lawyers and regulators should continue to ensure that individual lawyers are disciplined where appropriate.

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?

The concept of entity based regulation and a risk based approach are in fact separate issues. However, in changing the focus from the regulation of individuals to the regulation of entities, a risk based approach to regulation is also needed to accompany this shift. We note that the Solicitors Regulatory Authority has begun to place greater emphasis on managing the risks to users associated with a legal practice as a whole while maintaining solicitors' obligations to abide by their professional codes. The introduction of a licensing regime for ABS will require the SRA and other licensing authorities to go further in this approach.

We agree that licensing authorities should move towards a risk based approach to the regulation of ABS. The Better Regulation principles and Hampton Review and the approaches adopted by other major regulators such as the Financial Services Authority (FSA) and the Food Standards Agency as well as regulators of other professionals all point towards a risk based approach and a move away from a programme of routine inspection which ignores the risks posed by particular activities. A risk based approach is also highly practical because of the fact that it is not possible to monitor all practices at all times.

At this stage we can only contribute to the debate about how a risk based approach might work in theory. Apart from point out one or two of the key issues faced by a regulator, we are not in a position to define in detail the nature of the task. We would refer to the key objectives of all legal services regulation, which must be to protect consumers and maintain and promote public confidence in legal services and their regulation. In the words of the LSB itself, it is 'responsible for ensuring that the highest standards of competence, conduct and service in the legal profession are maintained for the benefit of individual consumers and the public generally.'[5]

Although there is a broad consensus on the theory of a risk based approach, it is not so clear as to how it should work in practice. The essence of risk based regulation has been described as 'distinguishing what matters'[6]. Therefore what are the factors which should guide a regulator in determining the risks posed by a particular firm? Three key considerations are as follows:

> In financial services the risk of a firm becoming insolvent and the loss of client's money are the key financial risks for consumers and the regulator's focus is on these areas. In legal services, the financial risk is limited by the fact that lawyers are usually only the custodians of client monies for a short time.

> In financial services, size is an important indicator as to risk and it is easy to see how many consumers may be affected by the breaches or failure of a bank or insurer. The legal market is again different. What probably matters more are the nature of the client base and the nature of the legal specialism. Some law firms (including many large ones) will predominately act for corporate clients who have their own legal advisors and thus deal on equal terms with

[5] Legal Services Board, 'What we do' website 20 Jul. 09

[6] Callum McCarthy, Chairman FSA 'Risk Based Regulation the FSA's experience' 13 February 2006

each other. Possibly as a result of this, some practices attract fewer complaints than others (often smaller) that are more consumer facing.

> The nature of the legal specialism is also likely to have a significant bearing on risk - with the risk of poor advice and outcomes being higher in some areas than others.

While there are clear differences between the regulation of corporate and individual services, the recommendations of the Smedley Review of the Regulation of Corporate Legal Work[7] do highlight some important suggestions. In particular that there should be a stronger ongoing engagement between the regulator and the regulated. The shift of focus to systemic issues such as risk management and governance will point inevitably to an entity rather than individual based approach. However as the report makes clear: '*None of my recommendations for change affects the core values of what it is to be a solicitor. All solicitors would continue to be subject to the Solicitors Act, the SRA's prevailing code of conduct and the Solicitors Accounts Rules and Professional Indemnity Rules*[8]'.

We agree that there will be similarities between the regulation of large corporate law firms and the future regulation of ABS which may also be large businesses. They will demand similar regulatory tools more appropriate to larger businesses. However, as borne out by the current approach of the SRA and the recommendations in the Smedley report, the conduct rules will not be dropped and will continue to apply but it does imply an additional focus on broader issues of governance and risk and the management of the entity as well as the conduct of individuals.

Adopting a risk based approach rather than applying equal supervision to all, will require regulators to measure the risk of a particular occurrence or event. In its measurement of risk, the FSA adopts a formula of the likelihood of occurrence multiplied by the impact it would have if it did occur. The FSA will determine the level of supervision from close and continuous to statistical/thematic and resource allocation to a particular activity depending on the measurement of risk in accordance with the formula. Can a similar measurement of risk be applied to legal services? The answer is unclear. Our concern is to ensure that the issue is investigated using a methodical approach while leaving scope for judgement.

[7] Review of the Regulation of Corporate Legal Work, Nick Smedley (2009)

[8] Review of the Regulation of Corporate Legal Work, Nick Smedley (2009) as above

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

We would advise a cautious approach to principles-based regulation. We acknowledge the drawbacks of rules based regulation in that it can be inflexible and can lead firms to seek to find ways round the rules. However, we have always maintained that our final verdict will depend on a clear improvement in consumer outcomes. Whilst, in theory a principles based approach can increase the responsiveness of regulation, there are a number of reasons why we remain concerned.

Firstly, it can lead to a lack of clarity for firms and for their customers. This can make regulation more expensive for firms as it makes compliance more difficult. It can also harm consumers as they are unable to identify circumstances in which they have been treated badly and merit redress. In order to address this, any industry guidance on how to interpret principles should be drafted carefully.

We are comfortable with the LSB stating clear high level principles that must be adhered to in many areas. However, the front-line regulators need to make sure that ABS firms are fully informed as to how these principles are likely to be interpreted. This clearly involves a dialogue between all parties, including consumers and consumer groups, which it is up to the LSB and the front-line regulators to initiate and facilitate. In addition, the LSB should not be afraid to take a more prescriptive approach, where there are clear areas of risk or where a specific way of operating would be clearly preferable.

We are interested that there may be a link between the incorporation of a legal practice and lower levels of complaints as demonstrated by the experience of the Office of the Legal Services Commissioner in New South Wales. The link may indicate more effective management of such practices. It may also indicate that those practices which have taken advantage of the opportunity of incorporation also demonstrated a progressive attitude to complaints handling.

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

The Act requires at least one of the practice managers to be authorised in relation to a licensed activity. It also prohibits a licensing authority from imposing a requirement that all managers should be lawyers. However it is left to the licensing authority's discretion to introduce further entry requirements such as tests of

suitability or competence or a requirement that the majority of managers should be lawyers.

The requirement of having a majority of lawyer managers acts as a proxy for a test of suitability, which in turn is aimed at protecting consumers. Such a requirement has obvious limitations in delivering consumer protection and may also have some disadvantages. Moreover it risks replicating the current requirement that owner/managers should be lawyers. If the same consumer protection may be provided by addressing the risks of the involvement of unqualified owner/managers head on rather than by proxy, than this would be a more efficient and proportionate solution. One way to do this is to devise a 'fit and proper' test as currently applied to non-lawyer managers in LDPs.

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?

The 2007 Act also states that each ABS firm must have a Head of Legal Practice (HoLP) and a Head of Finance and Administration (HoFA), but it does not specifically state that they must be different people.

A HoLP and a HoFA are separate and distinct roles and we would support a requirement from a licensing body that these roles may not be performed by the same person. As well as being different roles, the positions provide a level of accountability to each other and form part of the internal checks and balances of a practice.

A fit and proper test should be aimed at determining the suitability and character of the individual. Our recommendation would be to apply the same test to non lawyer managers as is applied to those individuals wishing to become solicitors. The test focuses on past criminal activity and results of a Criminal Records Bureau checks. There is an important difference to bear in mind; most (but not all) applicants to become solicitors or barristers will be doing so at the start of their professional lives. Therefore they will not have had the opportunity to be involved in or have responsibility for businesses and face the risk which it entails. The applicants to be owner/managers are more likely to have had significant experience of business. As a result they may have had greater exposure to risks of say business failure.

In addition to basic information about past convictions we would wish to see the fit and proper test include qualities similar to those raised by the FSA's test for

approved persons carrying out controlled functions, namely; honesty, integrity and reputation, competence and capability and financial soundness.

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

Licensing regimes are frequently focussed on the granting or refusal of licences at the point of entry, with little ongoing involvement by the regulator. We support the ongoing regulation of legal services to ensure that the circumstances which led to the granting of a licence continue and that no changes which might justify a review of the grant of the licence or any conditions imposed upon it.

We support a compliance led approach which errs towards the granting of a licence to a new type, and therefore potentially higher risk, ABS entity rather than an over cautious refusal. However such an approval would need to go hand in hand with ongoing monitoring of the firm to ensure that the circumstances which led to the granting of a licence continue.

Consequently, we support the provision of a higher level of supervision for licensed firms whose activities are considered to pose a higher risk and which therefore require a more intensive relationship with the regulator, including inspection visits carried out in person rather than completion of a paper based audit exercise. This approach is consistent with a risk based style of regulation as discussed above.

In financial services the risk of financial failure represents one of the key risks. In relation to legal services misconduct and mismanagement and damage to reputation of the service provider and regulator are at least as important, both in the probability of their occurring and their impact. As such, there should be a focus on both areas of risk.

In terms of corporate failure, we do not advocate a zero failure approach; it is unavoidable that some licensed practices may fail and an attempt to control risk to the extent of preventing all financial failure would unreasonably constrain business. Nevertheless, large scale financial failure with consequent consumer detriment would have a chilling effect on ABS and on consumer confidence in the legal professions. It will be important to strike the right balance.

We would advocate an approach which takes into account the impact on public confidence in the reform of legal services. Previous research[9] seems to suggest a broadly positive attitude towards the business structures underpinning legal services, in as much they were understood by consumers. Recent experience with the banking sector would suggest that this confidence is easily lost when things go wrong and while legal services do not present the same systemic risks and therefore would not require the same levels of intervention, the consequences of failure would be significant.

[9] Mori 'Attitudes Towards Alternative Business Structures' 2004

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

The business structure of a legal firm may or may not have an impact upon the level of risk presented by that practice. We agree with the proposition that some ABS firms may in fact be lower risk than some legal practices. Any intervention and differences in the approach to regulation between traditional practices and ABS should be based on evidence rather than assumptions about risks presented by any particular business structure. Part of ensuring a level playing field will require an outcomes-based as opposed to a prescriptive model of regulation. There will also need to be consideration of the risks presented by the activities of the entity as a whole rather than an approach based simply on the qualifications of individuals.

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

Access to justice should not be confined to face to face legal advice from a qualified solicitor or barrister. Access to justice may be delivered in a variety of ways by a variety of providers - indeed some areas are already commoditised. As such, the delivery of more services and information at a distance (and in particular online) could, for certain people, help discharge the obligation to provide access to justice.

We anticipate that providers seeking to use ABS will also seek to exploit information technology with a view to providing legal services online. Some online legal services have already been commoditized providing standard administrative focussed services such as conveyancing and general advice. Some commentators envisage that this trend will continue and that it will be applied to complex problems and to personalised services.[10]

While there may be new methods of delivering access to justice in a meaningful way to a wider range of consumers, we should be careful to note the special needs of vulnerable consumers. Such consumers are still likely to depend on the traditional method of providing legal services face to face.

In addition, there are some areas of the law, such as criminal or family law, that will be harder to deliver without face-to-face contact.

[10] Richard Susskind 'The End of Lawyers' 2008 Oxford University Press

We agree that it is likely to be only in very special circumstances that an ABS licence should be declined on the basis of the failure to meet the access to justice condition alone. Any such action would involve attempting to anticipate the impact on the market of the entry of a particular provider, an impossible task and one that is better left to competition authorities looking at the market as a whole as opposed to licensing bodies.

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

There is no evidence to suggest that ABS of itself will present greater risks to traditional practices. However we can see from the entry and evolution of volume providers delivering services in one particular field, that they may present different risks to the current profile of a legal practice by servicing fewer clients and providing a bespoke service across a range of specialisms. In dealing with the risks we would expect professional indemnity brokers and underwriters to price and offer products against these risks in accordance with market forces and industry practice. While some have argued that the ABS would lead to an erosion of professional standards and greater risks as a result of the demands of external investors for a return, it is also true to say that external investors will require the business to succeed. Therefore, the fear that the pressure to act unethically or to cut corners and provide a poorer service may be overstated.

We may be dissatisfied with the way in which claims by consumers are dealt with by lawyers and their insurers, particularly the fact that establishing negligence will often require further legal action. However, we are not aware of circumstances where consumers have faced problems arising from the lack of insurance cover held by the lawyer. The current insurance arrangements which apply to solicitors and barristers appear to work well from the consumer point of view by providing effective and seamless cover in the event of a claim. We would advocate the adoption of compulsory insurance for ABS and we would be keen to ensure that the current protection provided by the indemnity and compensation arrangements is not undermined by ABS. ABS firms should be under an obligation to provide adequate insurance cover in the event of a claim by a consumer and this should be a license condition. The precise details of how that cover should operate are outside the scope of our response to this consultation. However it will be instructive to see how the insurance market responds to ABS in its pricing of the risks, as the premiums should reflect any changes to the risk profile.

We agree that the primary concern for legal services regulators should be the safety of client monies rather than the financial stability of the firm. There are measures

which are invoked for the transfer of files of work in progress in the event of the failure of a firm. However consumers' claims that arise against firms who are insolvent should be borne by their insurers. While we do not advocate that the regulators become overly concerned with the financial state of individual firms, they should use their licensing powers to ensure that adequate insurance arrangements are in place.

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

The Act provides for the Office for Legal Complaints (OLC) ombudsman service to have jurisdiction over unresolved complaints made by users of ABS practices. We would expect that jurisdiction to be invoked on a similar basis to the current practice; that generally it should only be made available where internal processes have been exhausted and that firms should be given the opportunity to resolve complaints by agreement with their users. However there will be circumstances where it will be necessary for the OLC to intervene before the exhaustion of the complaints procedure, for example, where the firm has refused to engage with the process or that there have been unacceptable delays. The system should therefore provide for a degree of flexibility in relation to jurisdiction in order that complainants are not held in limbo.

We would not wish to see the implementation of materially different arrangements for complaints handling for ABS firms than exist for traditional firms. However this does not mean that we think that the complaints procedures have worked well. As highlighted in the Clementi Report[11], the complaints system for solicitors in the past has been slow and ineffective. The process has been characterised by an adversarial and procedural approach lacking clarity and consistency and independence.

Many of the reforms brought about by the Act were aimed at improving complaints handling and implementing the recommendations of the Clementi report. However the Legal Services Ombudsman remains critical of the overall performance by the Law Society's Legal Complaints Service, while welcoming improvements in turnaround times and service delivery[12].

[11] Sir David Clementi 'Report of the Review of the Regulatory Framework for Legal Services in England and Wales' 2004

[12] Office of the Legal Services Ombudsman for England and Wales Annual Report 2008-9

We are positive about the prospects for complaints handling and we welcome the introduction of modern and progressive approaches which may accompany the introduction of ABS. For example a large retail brand that has in place a professional complaint handling set up may provide a more effective way of resolving consumer problems than has been done by the Law Society in the past. It is important that the lessons of the past are learned and that the mistakes are not repeated.

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?

Two main risks to the regulatory objective of promoting lawyers' adherence to their professional principles have been identified; firstly, the interference by owners who exert pressure on management to act in a way to compromise their professional principles and secondly, the potential for conflict between a the duties owed by a lawyer to his/her client and the duties owed by a director to a shareholder.
A fit to own test will go some way to mitigate the risks in relation to the interference by an owner who exerts pressure on the management including the specific problem of organised criminals who seek to influence an ABS. However, it is unclear how the fit to own test will address the second risk, which is more of a commercial risk, without also clarifying the circumstances where the conflict will arise and how it should be managed.

We understand that a material interest is 10% and a controlled interest is greater than this and that more onerous obligations should apply to the controlled interest. However we are unclear about how these tests will apply. It will be a matter for the licensing bodies to resolve this.

The constitution of the ABS, for example, the memorandum and articles of a company may provide an opportunity to detail the hierarchy of duties owed by directors and employees of the company. We agree that that this may not be necessary in the light of the statutory duties relating to fitness to own however it would go some way in clarifying matters for officers and investors of a company. Licensing bodies will need to take account of the current rules that apply to different business structures, for example, the Companies Acts 1985 and 2006 and the Partnership Act 1890 and to what extent the requirements in those statutes are replicated by licence conditions. Licensing bodies will need to take account of the difference between the application of the fit to own test in relation to private and public companies. Whereas the extent of the interest can be controlled in relation to a private company we cannot see how restrictions on the ownership of shares in

a public company might be applied where its shares are quoted on the stock exchange.

There appears to be an assumption by opponents of ABS that a partnership structure restricted to ownership and management by lawyers provides greater protection against corruption and unethical practice than a corporate structure with external share ownership. In our view, it does not necessarily follow that corporations are more vulnerable in this respect.

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

Under the Act 'reserved activity' means: (a) the exercise of a right of audience; (b) the conduct of litigation; (c) reserved instrument activities; (d) probate activities; (e) notarial activities; (f) the administration of oaths.

We agree that widening the scope of the definition of reserved activities does risk introducing further restrictions which may have the effect of creating market distortion. We do not have any evidence to demonstrate that such a step would bring real benefits to consumers and therefore we would support the proposal to retain the current definition.

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 those bodies?

Users of special bodies face some of the risks as other consumers of legal services, namely, poor quality advice and negligence, inadequate complaints handling or loss of client money. In response to these risks, the regulation of such bodies must aim to ensure equal protection for consumers who may also be vulnerable and in particular need of legal assistance on matters that are critical to them.

Other risks which generally arise from commercial work such as conflicts of interest will be less relevant to clients of special bodies and regulators can take a less stringent approach to the regulation of these.

According to the 2007 Act, not-for profit organisations, community interest companies and trade unions are all allowed to carry out reserved legal activities without authorisation for an unspecified "transitional period". Thereafter, they will be licensed as "special bodies" and as such it is expected that they will be subject to a different approach from the regulators.

How different that approach might be should depend on the entity involved: for example, a law centre might involve both profit-making and not-for profit elements. Regulators should be wary of adding to the costs and complexity of "special bodies", but also conscious of the need to protect the consumer and so the adoption of an outcomes based, entity focussed regulatory approach would allow the licensing authority to judge when to demand more stringent requirements. We support the proposal that legal firms that do not stray too far into ABS territory – those with less than 10% non-lawyer management and ownership (perhaps a traditional legal firm that makes their IT Manager a partner) – should also benefit from a lighter regulatory touch as they will be very similar in structure to traditional law firms which are outside the jurisdiction of these regulatory changes.

We note that the SRA has set a threshold of 25% non-lawyer managers in relation to LDPs. This does raise the question of whether the LSB should follow this lead and recommend whether bodies with less than 25% rather than 10% of non-lawyer managers should qualify as special bodies. The choice of the threshold figure will have an impact on the size of the entity which might apply; if the figure is set at 10% an ABS applicant must have at least 10 managers to qualify but by setting it at 25%, a firm of 4 may qualify. We would be concerned with the potential unintended impact on the access to justice particularly in rural areas by excluding organisations with less than 10 managers. We would be concerned that this would effectively exclude all but the largest organisations.

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?

We consider that not-for-profit ABS organisations in particular should have regulation tailored for them, just as the FSA has special rules for credit unions and just as the OFT issues a single group licence for Citizens Advice's network of bureaux. The approach of the FSA has been to isolate the core risks which are faced by customers of not for profits in the financial sector such as credit unions and to ensure that those risks are mitigated. However where regulation is aimed at dealing with risks arising from commercial work, these regulations may be sidestepped. Trade unions are currently exempt from the requirement to seek a licence apparently on the basis that they provide legal services to a closed group of users, the members. Therefore, trade Unions will only need to apply for ABS status if they offer legal services to members of the public other than their members, which seems unlikely to happen. However where trade unions engage a legal firm to

provide specialist representation and advice to members, that provider will be subject to the licensing regime.

In short, we would support a lighter touch approach to the regulation of "special bodies"; a more heavy handed one might well be counterproductive in championing consumers' welfare.

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

No