LEGAL SERVICES BOARD

Alternative business structures: approaches to licensing

Summary of all responses by questions in the November 2009 consultation paper and the LSB's response

Contents

Introduction

1. On 18 November 2009 the Legal Services Board (LSB) issued a consultation paper[1] "Alternative business structures: approaches to licensing". This paper built on the discussion document on Alternative Business Structures (ABS) issued in May 2009[2]. The November consultation document drew together the LSB's thinking on a number of policy areas that have informed the guidance that LSB has published on the content of licensing authorities' (LAs) rules.

2. The November consultation document identified and discussed the following policy areas:

   - A new approach to regulation - structure of licensing framework
   - Ownership tests
   - Indemnity and compensation
   - Reserved and unreserved legal activities
   - LA enforcement powers and financial penalties
   - Access to justice
   - Appellate bodies
   - Special bodies
   - Head of Legal Practice (HoLP) and Head of Finance and Administration (HoFA)
   - Complaint handling for ABS
   - Diversity
   - International issues
   - Legal Disciplinary Practices (LDP)s, Recognised Bodies and other similar entities
   - Other issues
   - Regulatory overlaps

3. We received 46 responses to the consultation (see annex A). All non-confidential responses have been published on the LSB's website. This document sets out a summary of the key issues raised by respondents to the LSB's consultation under these headings. It also sets out the LSB's response. This paper is published alongside a guidance document which provides more detailed and technical guidance on each issue following the requirements of the Act.

[1] http://www.legalservicesboard.org.uk/what_we_do/consultations/2009/pdf/consultation_181009.pdf
[2] http://www.legalservicesboard.org.uk/what_we_do/consultations/2009/pdf/140509.pdf

Outcomes and the structure of a new licensing framework

4. Most respondents who had a view were generally supportive of our proposals in this section of the consultation paper. There were a number of dissenting views on both the outcomes identified and the outcome focus of the proposed framework.

5. A large majority of respondents thought that there was a good case for having consistent outcomes for all ABS. Outcome regulation was welcomed by a very large proportion of respondents including the Institute of Chartered Accountants for England and Wales (ICAEW), the Institute of Chartered Accountants for Scotland (ICAS), the Association of Partnership Practitioners, the Bar Standards Board (BSB), the Legal Services Commission (LSC), the Motor Accident Solicitors Society, the Institute of Legal Executives (ILEX), ILEX Professional Standards Ltd, Irwin Mitchell LLP, the Co-operative Legal Services, the Royal Institute of Chartered Surveyors (RICS), the Tunbridge Wells, Tonbridge & District Law Society, the Law Society and the Solicitors Regulatory Authority (SRA). The Chester and North Wales Law Society thought that the wide variety of business models possible for ABS would make a prescriptive approach difficult to implement and unwieldy. RICS spoke of their success in implementing an outcomes based approach to regulation.

6. One respondent thought that the LSB did not have the power to require LAs to adopt outcomes and argues that LSB could only require outcomes if the LA was being unreasonable in regulating through rules. A number of respondents including the Law Society thought that there should be a good deal of autonomy for the LAs in developing their rules.

7. The Hertfordshire Law Society was concerned that outcomes based regulation may not be appropriate for very large ABS where large numbers of consumers could be adversely affected before the regulator is alerted to what is happening. The Council of Mortgage Lenders was concerned that an outcome approach would be at the expense of more detailed oversight. However, a number of respondents thought that a risk-based approach to regulation was desirable for ABS. The Legal Services Consumer Panel thought that it was vital that LAs collect enough information to identify early warning signs.

8. Some respondents including the Advice Services Alliance (ASA), the Faculty Office, the Solicitor Sole Practitioners Group and the City of Westminster and Holborn Law Society thought that rules may be more appropriate. The City of Westminster and Holborn Law Society said that it was not appropriate to abandon certainty for professionals in all cases and the Solicitor Sole Practitioners Group thought that outcomes by their nature were subjective and therefore difficult to enforce. The ASA thought that detailed rules were needed

for core areas of consumer protection and that the absence of clear rules may be too time-consuming. The Bar Association for Commerce, Finance and Industry thought that experience will necessitate specific rules and that the outcomes should be as detailed as possible to reduce the necessity of extensive guidance. The CCBE thought that less complicated, clear and transparent rules based on the core values of the legal profession were more likely to support firms and encourage compliance but this was as an alternative to ABS rather than part of it.

9. The outcomes suggested in the paper were broadly agreed with. The College of Law agreed the outcomes but thought they were vague in places. One respondent thought that the outcomes identified blurred the distinction between principles and outcomes. ICAS hoped that the outcomes based regime could evolve as the new regulation was put in place and became operative. ILEX thought that not all the proposed outcomes were outcomes and that a smaller list would be more consumer friendly. The SRA agreed with most of the outcomes but thought that the professional indemnity insurance (PII) outcomes were too detailed. The City of London Law Society thought that an outcome should be the promotion of competition as in other sectors there has been consolidation that authorities have not been able to address. The Co-operative Legal Services agreed with the majority of outcomes but wanted to have more clarity about the current situation for reserved and unreserved activities.

10. The proposed individual and entity split was widely supported. However, a large proportion of respondents thought that individual and entity regulation should not be considered independently and that a holistic approach was required. A number of respondents thought that the list of considerations needed adapting. The Council for Licensed Conveyancers (CLC) thought that business planning and wider financial issues such as cash flow forecasts would better inform their understanding of the inherent risks. ILEX thought that financial viability should be a consideration as should information on recruitment and retention for diversity and social mobility. Irwin Mitchell thought that entity considerations should include: adherence to regulatory objectives, risk management, internal audit, quality of service standards, diversity policy, and social responsibility policy.

11. The Legal Services Consumer Panel thought that ABS should be subject to the same disclosure requirements on referral fees that the SRA currently has, at least until the wider review is complete.

LSB's response

12. We agree with those respondents who have argued for a consistent approach between ABS entities and the existing market. However, we believe that much of the potential benefits of ABS may be lost both to new entrants and existing

firms if ABS are pushed into the current framework. There are opportunities to use the advent of ABS to modernise the regulatory framework for legal services more generally and to move it to an outcomes based approach which protects professional principles whilst giving new commercial flexibility.

13. We do not consider that this in any way equates to so-called “light touch” regulation. Effective, risk-based enforcement by LAs (and ARs) backed by appropriate sanctions against transgressors will ensure that consumers are protected and that they have confidence in their legal service providers.

14. This does not preclude different requirements for ABS, but any such requirements, which must be founded in the specific additional requirements of the Act, must be related back to the evidence of risk associated with a particular issue. Where risks are common, regulation should be common. Where they are different, the responses should be different but always proportionate. And the different response is likely to manifest itself in differing supervisory arrangements rather more often than in different rules.

15. We think that the introduction of ABS should allow the largest possible range of alternative business models. This is not a matter of blind faith. Rather, ABS allows the restrictions that have been place on legal services businesses to be lifted and the regulators should look at the risks associated with individual businesses rather than ruling out whole classes of businesses.

16. We think it is possible and desirable for LAs to identify what their regulation is trying to achieve and the types of risks that it is trying to mitigate. These risks are likely to be expressed in different ways in different business models and need to be addressed in different ways. We see that outcome based regulation needs to go hand in hand with regulators taking a risk-based approach to their supervision. It seems likely that the level of risk associated with say a two person firm will be different to a large corporate multi-disciplinary practice (MDP) but we think the types of risks that the regulator should be live to will be the same.

17. We were pleased to hear of RICS’s success of implementing an outcome based approach to its regulation. We agree with the Consumer Panel’s position that the collection of good quality information to base LAs’ assessments on will be vital. We expect that all potential LAs will indicate what information they will collect, how they will do so (including how often, in what form, etc.) in order to make timely and proactive interventions. We also expect that LAs will improve at this over time as the regulators develop a better understanding of what is an “early warning sign” and as they become aware of different risks to the regulatory objectives.

18. We have some sympathy with the view that rules may feel easier to comply with. However, it is our view that an over-reliance on rules may stifle innovation. There will be times when there is only one right way of doing things, but we think there will be many more situations where one way might work for one firm but there is a better way for other firms to achieve the same ends.

19. We were pleased with the support on the proposals to have outcomes. We also agree that some of the proposed outcomes may have been at too fine a level of detail. We think that there is a core of outcomes that should apply to all LAs. We have reworked the outcomes and the final list forms part of our guidance on licensing rules.

20. The issue of defining a split between individuals and entities is difficult. We agree with the comments that a holistic approach to regulation is required. On consideration, we are now of the view that any list of entity and individual considerations will be imprecise in demarcating a split. It is therefore our view that LAs should consider how their rules apply to individuals and the entities that they work in and show how the sum of their rules add up to the required level of risk information, supervision and enforcement to meet the objectives of the regulation.

21. We agree that if there are disclosure requirements on referral fees for non-ABS then this should also be the case for ABS. But we do not currently have sufficient evidence to require disclosure in all circumstances.

Relevant guidance

Relevant paragraphs in the guidance to licensing authorities on the content of licensing rules are 5 – 30 and 36.

Ownership

22. We received 31 responses to this question. A large majority were in favour of our approach. However a number of issues were highlighted. There was broad consensus that the ownership tests applied should be as close as possible to the requirements of Schedule 13 of the Act. There was an appreciation of the difficulties of applying Schedule 13 but there was a strong feeling that it was necessary to achieve good outcomes for consumers. There was very little appetite amongst respondents for too much adaptation for small firms. The Solicitor Sole Practitioners Group thought that the LSB should prevent the watering down of the provisions of the Act.

23. Most respondents thought that it was appropriate to have consistent tests across all the licensing authorities. ICAEW, ILEX Professional Standards Ltd, the SRA and the BSB thought that the LSB should not be too prescriptive and allow LAs to adapt the application of Schedule 13 to suit. The College of Law thought that where consumers were dealing with an ABS they should be able to assume that the ownership tests for all such bodies were the same and consistently applied.

24. The Office of the Immigration Services Commissioner (OISC) thought that the LSB may be premature in deciding that there should be no limit to external ownership, rather it should wait to assess LDPs. The Motor Accident Solicitors Society thought that there should be a limit on the non-lawyer ownership in firms and the majority of directors should be required to be solicitors in order to keep control of ABS within the profession.

25. Many respondents thought identifying associates would be difficult. Most respondents thought the application of *de minimis* criteria to the application of the tests was appropriate and without such a limitation the tests would not be proportionate. The College of Law was concerned that presumptions of fitness and *de minimis* rules might lead to unnecessarily complex arrangements designed to avoid closer scrutiny. The Law Society agreed with the approach as long as it was sufficient to identify owners acting in concert.

26. On the issue of disclosing the ultimate beneficial ownership most respondents thought that it was appropriate to consider who the ultimate owner was. The City of Westminster and Holborn Law Society did not think that it was practicable to identify all owners.

27. The City of Westminster and Holborn Law Society thought that it was worth considering requirements for individuals exercising their voting rights certifying that they have not been influenced in their voting behaviour or asked to inform the HoLP if anyone seeks to influence their votes.

28. All respondents who commented on the issue thought that spent convictions that related to fraud or dishonesty should be required to be declared. Some respondents thought all spent convictions should be declared. The Legal Services Consumer Panel also thought LAs should be able to refuse an application in case of a false declaration and that pending issues should also be declared. ILEX Professional Standards Ltd. suggested that we consider whether external owners should also declare cautions and other out of court disposals.

29. The Council for Licensed Conveyancers thought that would need to be an amendment to the Rehabilitation of Offenders Act 1974 to provide a definitive answer on exemption. A number of respondents thought that issues that fell short of disqualification should be collected and be used as part of the decision making process.

30. Respondents had slightly negative views about introducing a hierarchy of duties along the lines of the Australian model. Some like the Liverpool Law Society thought it was important to make clear that the duties of shareholders and stakeholders were those owed under sections 170 to 187 of the Companies Act 2006. The Law Society thought that the idea needed more work and Irwin Mitchell LLP thought that all stakeholders listed or not should be aware of the anticipated regulatory obligations. The City of London Law Society thought that the Australian regime may not be feasible.

31. There was some scepticism of the extra divestiture suggestions in the paper, one respondent didn't think that they would work for international owners and many thought that if it was introduced, if shares were bought back it should be at the current market value.

32. In general, there was little support for the idea of using covenants as part of the regime. Many thought that they were not needed given the other requirements of the Act. Those who thought covenants might be appropriate such as the Tunbridge Wells, Tonbridge & District Law Society thought that they would need to be backed by appropriate assurances, for instance financial guarantees and bonds. The ICAEW noted that they used covenants as part of their regulations and could see the value of them in relation to ABS where influence leads to action that is in conflict with the duties required under the Act.

33. One respondent thought that the challenge for LAs would be to monitor ownership on an ongoing basis and the obligation to inform changes in circumstance may be difficult to address in practice.

34. The BSB thought that there was not enough detail of the risks attendant on non-lawyer ownership and how these may be mitigated. The Solicitor Sole

Practitioners Group had considerable scepticism as to whether the outcomes were achievable at all. The CCBE thought that non-lawyer owners would not have the same incentives as lawyers whose interest in making a profit is tempered by their professional ethics. However, the Bar Association for Commerce Finance and Industry stated that "we should not assume that new (for legal services) more commercial forms of ownership and management will be any less ethical or customer focused than the current forms".

35. RICS thought that bodies that were already regulated by other bodies should be subject to less stringent checking.

36. The ASA thought that "ownership" was not a useful description for special bodies although the same tests should apply. They also thought that the requirement to have at least one authorised person manager may be difficult to manage and may need to be considered under the special body provisions.

LSB's response

37. Consumers need to feel confident that legal services obtained through an ABS are of at least similar quality as those obtained through conventional law firms. Therefore in order to ensure consumer confidence in all forms of ABS, we consider that there must be a uniform test for all LAs based directly on the requirements of Schedule 13 to the Act, for all owners of an ABS, whether they are lawyers or non-lawyers. Although we recognise that many professional bodies and other regulators already conduct fit and proper tests for their members, these may not be the equivalent tests to those required by the Act or in our guidance. We therefore do not consider that those who have undergone those tests should be "passported" in to the ABS regime. However, for those people the requirement to undergo ABS-specific checks should not be a greatly increased burden.

38. In terms of a requirement to disclose the ultimate beneficial owner, we consider that this is a reasonable requirement. It must be a requirement for the licence applicant to provide this information with appropriate evidence to verify it.

39. Although there may be a limited number of cases where it may not be appropriate to disclose publicly who an owner is (for example if the owner is a blind trust), we consider that it there should always be a requirement to declare the identity of the owner(s) to the LA. Otherwise, any body who wished to hide its owners who were not fit and proper people could do so merely by their own constitutional documents.

40. We understand the concerns about whether it is appropriate or practical to impose requirements on ABS shareholders over and above those required by other legislation such as the Companies Act. Given the protection provided by

the Act in terms of the obligations (in section 90) on employees, managers and those with an interest an ABS not to do anything that causes or substantially contributes to a breach of the regulatory arrangements, and the requirements for fit and proper tests, we do not consider it necessary to prescribe additional requirements. It may, however, be appropriate for a LA in the particular circumstances of a licence application to require additional safeguards. We would expect any such requirement to be objectively justified, with a right to appeal against it.

41. In principle, we consider that there should not be restrictions on the extent to which non-lawyers should be allowed to own law firms. The implementation of the safeguards in the Act should help to detect undesirable owners, whether they are lawyers or non-lawyers. There are divestiture provisions in Schedule 14 to the Act that can be used when an owner is no longer fit and proper.

42. However, we recognise that there may be some LAs that will not be competent to regulate ABS with significant external ownership or complex structures (whether external or lawyer only). A Licensing Authority's licensing rules should set out the type of ABS that can apply to it for a licence. If this places restrictions on the extent or nature of external ownership then this must be fully explained and justified. In these circumstances we would not normally approve the LA's licensing rules unless the relevant AR's regulatory arrangements had been changed so that they did not restrict an individual regulated by it (as an AR) from working in an ABS that was regulated by another LA with a wider range of competencies.

Relevant guidance

Relevant paragraphs in the guidance to licensing authorities on the content of licensing rules are 10 – 11 and 106 – 128.

Indemnity and compensation

43. The majority who had a view on this issue responded positively to the consultation. Many of the responses emphasised that consumer protection should be the primary consideration. The level of protection should be consistent across ABS and non-ABS and there should be a level playing field between all firms. Overall coverage should be adequate to ensure a good level of protection for consumers. The Chester and North Wales Law Society pointed out that the opportunities that ABS presents for firms to take greater financial risks needs to be accounted for in considerations of consumer protection.

44. The OISC considered that though all LAs should require the same minimum PII levels for the same types of activity, it should not be based on existing levels.

45. Shelter, RICS and ABI supported appropriate levels of flexibility to promote innovation, though ABI advocates further study. However the Bar Association for Commerce and Industry considered a precautionary principle should apply and the customer's interest should override even if this increases costs. Co-operative Legal Services, The Law Society, SRA and Irwin Mitchell LLP expressed a preference to adapt the current scheme for non-ABS. The Association of Partnership Practitioners considered that minimum levels of cover should apply unless it can be demonstrated that some activities are sufficiently distinct.

46. A number of respondents did not support the minimum £2m for any one claim. Almost all respondents thought that the level of PII should reflect the level of risk. Many considered that there should be minimum PII levels set for all LAs for different types of activity. ILEX pointed out that setting minimum levels for all ARs may have an impact on competition. The Chester and North Wales Law Society disagreed with the point that large organisations may not need the same level of cover due to the financial liquidity. Irwin Mitchell LLP did not consider that a minimum level across all LAs was realistic. The Bar Association for Commerce Finance and Industry thought that imbalance must be tolerated in the interest of consumer protection.

47. Most respondents did not think that a master policy was appropriate due to lack of flexibility, however it should not be ruled out. The Solicitor Sole Practitioners Group thought it might be appropriate if there were a common set of minimum terms. The ICAEW thought a master policy would work only where firms are homogenous. The SRA considered that master policies at least should not be prohibited, with the Law Society submitting it should be up to the individual LA. The Tunbridge Wells, Tonbridge & District Law Society

considered that all forms of PII should be considered. One respondent stated that for patent firms the PAMIA mutual insurer is appropriate.

48. There were mixed responses to the question of run-off. ABI, College of Law, CLC and others highlighted that run-off provides a barrier to orderly closure (exit), movement between regulators and entry to market. ABI pointed out the perverse incentive that the requirement to provide run off provides to insurers not to report fraud. ILEX considers that run-off cover for 6 years is essential. The ASA suggested run-off should be purchased with one payment in advance. There was support for the existing SRA arrangements and for SRA's proposals for reform.

49. There is considerable support for a compensation fund. Many considered that it should be the same as those of non-ABS. However, ILEX and CLC pointed out that establishing a new fund would be difficult. CLC went on to say that the CLC and SRA funds are an accident of history rather than a considered policy and may be difficult to replicate. The Law Society and the Association of Partnership Practitioners did not consider it appropriate that it be funded from the interest on client accounts. The ICAEW and the College of Law suggested that fidelity guarantee insurance should be considered, while another respondent suggested parental guarantees, letters of credit could be the appropriate route. ABI highlighted that a clearly defined fund, where insurers were not required to cover fraud, should assist in addressing PII cost issues caused by fraud. Irwin Mitchell LLP thought that each ABS should contribute having regard to the activities it carries out. One respondent and RICS considered it important to define whose dishonesty can trigger a claim on the fund.

50. The Motor Accident Solicitors Society considered there should be a single fund, funded by ABS licence fees. Shelter and another respondent pointed out contribution should be related to risk. They went on to say that it would be unfair for professions with a small claim on a fund to cross subsidise other professions if there were a single fund. The Hertfordshire Law Society suggested consideration should be given to splitting funds between ABS and other providers of legal services unless proportionate contributions are made. Co-operative Legal Services, Tunbridge Wells, Tonbridge & District Law Society and the Law Society all considered that compensation funds should be the same as for non-ABS.

51. The Legal Services Consumer Panel did not agree that "consumers to make more informed choices about the risk that are prepared to take when obtaining legal advice" should be an outcome as most consumers expect legal advice to be risk free but there should be an explicit outcome of reducing risk to consumers.

LSB's response

52. We agree that consumer protection is the primary consideration and should be consistent across all ARs for the same activities. However to the extent that consumer protection is not compromised we also support a market-based solution and arrangements that are sufficiently flexible and proportionate to risk and promote competition.

53. Consumers do currently face some risk when receiving legal advice even if only in the length of time for resolution of issues of dishonesty and negligence. Available evidence suggests that the nature and extent of this risk is poorly understood. We see therefore see benefit in more information for all consumers through public legal education, which will help to make the market work more effectively by ensuring that consumers make better informed choices. However, such improvements will be slow to emerge and cannot therefore justify a transfer of risk to consumers or a materially different level of risk for consumers of ABS firms, as opposed to those in the current market.

54. We agree with an appropriate calibrated risk-based approach to indemnification, based on evidence of consumer protection and risk – where possible. We suggest will continue to work with ARs, insurers and other interested parties to consider appropriate approaches to indemnity and compensation in both ABS and non-ABS. Given that the issue of run-off cover may raise serious issues in relation to fraud and competition in the current market we will include analysis of the issues and options. We will aim to be in a position to publish this analysis in the fourth quarter of 2010. Given that firms are unlikely to be homogenous, based on the submissions, at this point we agree that a master policy may not be appropriate. However we do not think that master policies should be prohibited per se. We consider that a LA's indemnification requirements must be sufficiently flexible to allow a variety of products and approaches to develop to meet changing market conditions and provide appropriate levels of consumer protection.

55. A compensation fund is likely to be necessary where ABS hold client money to provide adequate levels of consumer protection, particularly where it will address issues of fraud that are not covered by PII. Issues of proportionately, difficulties involved in identifying the source of an issue resulting in a claim and the difficulty in establishing a fund will present challenges. We are committed to working with all parties to ensure that appropriate levels of consumer protection are provided.

56. For ABS, we expect LAs to provide compensation arrangements that cover sufficiently the risk of fraud not covered by PII resulting in hardship to retail consumers and SMEs. We do not expect compensation arrangements to provide compensation for large businesses or financial institutions. We do not consider that parent company guarantees are appropriate forms of

compensation. This is because in the event that the parent company goes out of business or files for protection from creditors, consumers are likely to be left with no means of redress. Although letters of credit may provide more certainty than a parent company guarantee, LAs should bear in mind that they have to be carefully worded to ensure that they will actually provide money in circumstances where there has been fraud. LAs should also take into account the cost of providing a letter of credit and the extent to which such costs (or those of any other compensation arrangements) are an unnecessarily high barrier to entry.

Relevant guidance

Relevant paragraphs in the guidance to licensing authorities on the content of licensing rules are 15 – 16, 31, 51 – 57, 93 – 94 and 102.

Reserved and unreserved legal activities

57. Around 60% of the respondents commented on the reserved and unreserved legal activities proposals. The majority of those that did respond were positive. There were a small number of negative responses.

58. Among those that responded there is widespread support for the LSB's position that ABS and non-ABS should be treated consistently and that, pending further work by the LSB, all legal services should be regulated as they are now. A number commented on the need to maintain a level playing field, with specific reference to the need to have the same freedom or restrictions on the ability to set up separate businesses for unregulated services.

59. A number of responses note the need for there to be a review of reserved and unreserved legal activities and that this is in the LSB plan for 2010-11. It was felt that this should include research to provide evidence of consumers' current understanding of legal services regulation.

60. There is common acceptance that consumer education is important but few suggestions on what this might mean in practice. A number of respondents have linked education to transparency and disclosure (of the services offered, how they are regulated and the redress arrangements). The City of Westminster and Holborn Law Society suggested that each licensing authority issue guidance to members on the key information to be given to consumers. Some responses propose that effective disclosure would reduce the need for consumer education. Again, the need for consumer research to inform thinking was a common theme.

61. Many of the responses that commented on how ABS firms that are part of a wider group should be treated agreed that they should be seen as a standalone entity; regulation should not be extended to the non-legal services undertaken by other firms in the group. Appropriate disclosure should enable consumers to understand the extent of regulatory coverage and protection.

62. Two responses, the R ICS and the ICAEW, took the position that more consultation and research was needed before any changes to the regime could be implemented.

LSB's response

63. Given the very difficult issues involved and the need for a great deal more analysis into what should or should not be a reserved legal activity, we are taking a pragmatic approach to this issue - the levels of consumer protection should stay the same as they currently are. So activities that are currently reserved (or unreserved) will remain reserved (or unreserved). If unreserved activities are currently (or in future become) regulated by an AR then they

should also be regulated by the relevant LA. This does not necessarily mean that it will be appropriate for ARs simply to copy their current regulatory arrangements on this issue (or any other) into their licensing rules. Consistency of consumer outcome, rather than maintenance of the status quo is the key aim to be achieved.

Relevant guidance

Relevant paragraphs in the guidance to licensing authorities on the content of licensing rules are 17 and 133.

Enforcement

64. A significant number of respondents that expressed an opinion agreed with the proposal that there should be an unlimited financial penalty against a licensed body or individual that had breached the licensing rules. One respondent provided a caveat to the support for unlimited penalties which was that LAs had to act proportionately. Another respondent that agreed with an unlimited maximum said that the size of the entity would provide an upper limit to its amount. The City of Westminster and Holborn Law Society thought that an unlimited fine was appropriate but this should be decided by an independent disciplinary body in the interest of natural justice.

65. Those that disagreed with an unlimited financial penalty did so for a number of reasons. RICS said that the discretion of "unlimited" would act against transparency and fairness and that there should be a published sanctions policy. The Law Society thought that the maximum financial penalty should be set at 10% of turnover.

66. Several respondents commented on the need for a consistent approach to the levying of penalties both within LAs and in their capacity as Approved Regulators. The SRA said that they would prefer to have the ability to have equivalent powers on all firms regulated by them. The College of Law said consistency of approach would provide transparent, risk-based and proportionate enforcement. Another respondent said that it would be helpful to know how the LSB will determine whether the approach of a licensing authority is appropriate and how it will achieve consistency between them. The SRA also said that an inconsistent approach between LAs was likely to be difficult to comprehend by members of the public. Several respondents said that the approach for ABS ought to be the same as for other traditional law firms.

67. The Hertfordshire Law Society expressed concern about regulators that become LAs having the skills to be able to effectively regulate large ABS which are likely to be far more complex than existing large practices.

68. Some respondents expressed concern that LAs may not have sufficient powers but did not provide any further details about where more power was needed. The Faculty Office said that any cost recovery by a licensing authority for enforcement action needs to be confined to ABS.

69. There was some agreement that licences should be capable of being modified but a variety of views about the circumstances under which modification should take place. The Bar Association for Commerce Finance and Industry said that licences should be capable of being modified under any circumstances subject to the condition that the LA must be able to explain why.

70. The ICAEW said that their own enforcement powers were adequate in relation to their own members (whether working in accountancy practice or elsewhere). Additional enforcement powers were therefore not required for the protection of their members' clients and third parties though they may be for other LAs.

71. There was some discussion about the means by which enforcement action could be taken against non-lawyer owners. The SRA said that s.43 of the Solicitors Act may provide a better means of addressing these issues. The Solicitor Sole Practitioners Group said that it was difficult to see how a non-lawyer owner with the "wrong motive" could be sufficiently deterred by the enforcement process. ILEX Professional Standards Ltd said that thought needed to be given to the means by which non-payment of a penalty might be enforced and suggested that the LSB maintain a register of any orders made. The Legal Services Consumer Panel suggested that the LSB list should be made public to act as a deterrent and provide the public with information.

LSB's response

72. We consider that the ability of LAs to levy unlimited fines in appropriate circumstances is a key means of protecting consumers by deterring inappropriate entry to the market and incentivising regulatory compliance. We consider that it is appropriate for a LA to be able to impose an unlimited financial penalty on either an individual working in an ABS or on the entity. We propose to make a recommendation for the Lord Chancellor's consent to set an unlimited maximum financial penalty. Potential LAs will have to provide their enforcement policy as part of the application process to become a LA. All LAs must have regard to the better regulation principles which require that their actions are, amongst other things, proportionate. That applies to the imposition of a penalty and modification of licence conditions as well as all other activities. We consider that this policy should be published in order to provide transparency about the way in which the LA will approach compliance and enforcement. For the same reasons we expect LAs to publish details of all financial penalties they impose.

73. There is a right of appeal provided in the Act to the appellate body if the individual or entity considers that the amount of the penalty is too high. Over time, this process will provide precedents to assist LAs in deciding what is an appropriate penalty to impose. A financial penalty is paid to the Government's Consolidated Fund; it does not directly benefit the LA financially. If a financial penalty is not paid, the Act (section 97) provides a means of pursuing the unpaid amount as a debt. We expect the cost of regulating ABS to be met, broadly, by licence fees.

74. In terms of a LA's ability to take action against an ABS owner, it is possible in some circumstances to divest the owner of their shares. In circumstances

where this cannot be done it may be appropriate for a LA to consider licence revocation if the owner is no longer fit and proper. Managers and employees in ABS can be disqualified from working in any ABS and we would consider it reasonable for licence conditions to prohibit ABS from employing anyone who has been disqualified. We can therefore currently see no reason to seek to change the Act by means of a s69 order to replicate provisions in other statutes. However, we have published an open letter inviting views on our preferred approach.

Relevant guidance

Relevant paragraphs in the guidance to licensing authorities on the content of licensing rules are 45 – 50 and 97 – 105

Access to Justice

75. There is almost unanimous support from those that responded on this issue for the need to monitor the progress of ABS and access to justice. Comments in support of monitoring also came from those that were on the whole against the concept of ABS. Several respondents said that it was important to monitor across the market and not just the actions of individual ABS. Some also agreed that it was important that there should be consistency of approach towards monitoring. Several respondents agreed that annual reports should be published. One respondent said that it would be burdensome for LAs to monitor access to justice independently of each other and there was a role for the LSB to ensure that there were consistent definitions. Another respondent said that it was for the LSB to develop policies on access to justice and to monitor it. Another respondent said that it would be for the LSB to decide whether or not a commercial activity should be permitted or not since a LA would not have the remit to do this. On the other hand one respondent said that the LSB should not influence a LA's interpretation of the requirements of the Legal Services Act.

76. Where respondents agreed with the approach to access to justice, they did so generally. Several liked the fact that the definition was broad. One respondent said that it was important to caveat any definition of access to justice with the word "affordable." Some respondents who agreed to the LSB approach said that they thought ABS would improve access to justice. Some respondents suggested that the definition of access to justice should take account of the quality of advice. The College of Law believed that the definition focused more on "access" than it did on "justice".

77. Where respondents disagreed with the approach there was more variation in the areas of disagreement. Some respondents disagreed not only with the approach to access to justice but to the concept of ABS. Several respondents expressed concern that ABS would see the removal of cross subsidies which would have a detrimental effect on access to justice. Other respondents said that it was important to ensure that ABS were not forced to do something that made no commercial sense. Others said that it was important for ABS to be on a level playing field with other types of law firms. Another respondent said that it was important to ensure that access to justice provisions did not act as a barrier to entry for entrants that satisfied other licence criteria.

78. In discussing the provision of face to face advice several respondents recognised that any definition of access to justice should go beyond this; others said that it was important not to discount its importance. Several respondents said that the definition of access to justice used by the LSB was not sufficiently clear. One respondent said that it was "disappointing" that the LSB had not taken the issue seriously. Some respondents disagreed with the

suggestion that potential licensable bodies should be asked to provide information in their application about how their business would improve access to justice.

LSB's response

79. The LSB welcomes the strong agreement that there is a need to monitor how the introduction of ABS, alongside other factors, affects access to justice. Consistency of monitoring will be important as no one LA will have a complete view across the market. The emphasis should be on ensuring that information collected is not burdensome and effectively illustrates the issues in question. We believe therefore that it will be important that we take the lead in developing the information requirements with LAs and others to develop what information is collected. It is important to recognise that ABS will not exist in isolation from other parts of the legal services market which also have an impact on the objective to improve access to justice. In developing the monitoring of ABS we believe that we should also look at the impact that non-ABS have on access to justice as well so that we can, over time, build a full picture of the impact the market has on this important regulatory objective. The development of market monitoring information is likely to take place outside the ABS project.

80. While the responsibility for collecting information about access to justice will lie with licensed bodies (and Approved Regulators) it will be important that there is agreement and acceptance of the indicators of access to justice. Therefore we remain of the view that any definition of access to justice must be wider than, for example, the provision of face to face advice or the type of advice provided to consumers.

81. We agree that in addressing access to justice there should be a level playing field between the requirements placed on ABS and those placed on non-ABS. This means that ABS should not be given obligations that are not also imposed on other firms in the legal services market. To do so will, we believe, contribute to the creation of barriers to entry in the legal services market.

82. We remain of the view that potential licensable bodies should be asked to provide, as part of their application, information about how they believe their business activities will improve access to justice. However we do not believe that this requirement in isolation will be sufficient to reject an application to become an ABS.

Relevant guidance

Relevant paragraphs in the guidance to licensing authorities on the content of licensing rules are 18 – 21 and 40 – 44

Appellate Bodies

83. Over half of respondents provided some response on the issue of appellate bodies. The majority of those responses were positive to a greater or lesser extent. Those who responded positively gave the following reasons: a single body would create consistency and help deliver best practice; it would make matters simpler; it would allow a common meaning to develop and ensure that a body of legal meaning on appellate issues could develop. Respondents were generally more positive about a single body for ABS than for the legal services market as a whole. In relation to the legal services market as a whole, several respondents said that more work needed to be undertaken. Several respondents offered suggestions regarding implementation. One respondent said that the appellate body for ABS should be set up before ABS goes live. Another said that in the first instance the appellate body should prepare to deal only with ABS set up issues such as appeals about ownership. A similar number said that the Tribunals Service was the appropriate body; others said that either it was not or they were not clear whether it was. One respondent said that no information had been provided on capacity or costs and more work was needed on the area.

84. The Master of the Rolls said that “it would seem to be contrary to the public interest for professionals from different branches of the profession and for professionals and ABSs to be subject to; a) different appeal structures and procedures; and b) differing jurisprudence”. He also saw the benefit of a single body responsible for all legal services appeals in the future but this would need a wider separate consultation.

85. Of those who responded negatively, one respondent felt that it was more appropriate for each LA to have its own appellate body and then have recourse to the High Court. They said that the First Tier Tribunal and the General Regulatory Chamber did not have any specific experience on matters of lawyers’ discipline. The Solicitors Disciplinary Tribunal said that it could take on the function with a little additional expenditure consequently making a significant saving on costs. This view was supported by another respondent who thought that while it was worth considering a single tribunal further, it was difficult to see why ABS issues could not be included within the SDT. One respondent said that it was inappropriate to replace the authority of an Approved Regulator and that a single body may undermine the roles of the LAs and approved regulators.

86. One respondent said that there were specific issues for non-legal regulators such as accountancy bodies that needed to be taken into account to avoid duplication. Another said that there was a link to the Civil Reform Bill (which would transfer the jurisdiction for appeals in barristers’ disciplinary hearings from the Visitors of the Inns of Court to the High Court) that had to be taken

into account. Two respondents said that the funding of the body should be proportionate to the number of appeals from a particular licensing authority. Several respondents questioned whether it would be more appropriate to have a single appellate body for all bodies at the same time.

LSB's response

87. Ensuring that LAs choose the appropriate course of action and that their decisions have the ability to be challenged by an independent body is very important. We were pleased by the support of respondents on this issue. We are attracted by the arguments that a single body would be able to develop consistency and share best practice. We do note that it is unlikely to be possible to establish a single body to hear all legal services appeals prior to ABS going live, especially because this would be an issue that would need to be consulted on independently.

88. We agree that further work needs to be done. We will continue to work with the Tribunals Service to develop this area further. This will include considering the costs and benefits of the various options and how the expertise built up in this area can be best utilised.

89. We recognise that there are other areas that require further development such as the implications of the Civil Reform Bill, the standard of proof that would be required by the appeals body and the route for further appeal. We will aim to have an agreed approach to these issues before the first applications to be designated as LAs.

Relevant guidance

Relevant paragraphs in the guidance to licensing authorities on the content of licensing rules are 22 – 23 and 129 – 130 (also 63, 71, 84, 101 and 105).

Special Bodies

90. Overall responses to the special bodies section of the consultation paper were supportive of the LSB proposals. Of those who responded to this question, two thirds responded positively.

91. The majority of respondents agreed with the LSB proposal that the transitional protection should come to an end at some stage. There was mixed opinion on the length of the transitional period. Many respondents agreed with the LSB view that the transitional protection should end after 12 months. Others were more cautious and felt that 12-24 months would provide a more suitable period of time. Citizens Advice felt that more time may be needed for special bodies to adjust to a different regulatory regime. Both Citizens Advice and ASA suggested that more discussion on the specifics was needed. A small number of respondents also commented that more time was needed for special bodies to consider their options once the ABS regime is up and running so that they could understand the full implications of becoming a licensable body. There was some suggestion that the transitional protection should remain in place for the time being but be reviewed in the light of experience. A small number also called for transitional arrangements to end as soon as possible to ensure equal protections for different consumers of legal services.

92. The majority of respondents agreed in principle that special bodies should be subject to regulation. Although many respondents commented on the relatively low risk of special bodies, there was a general consensus in the responses that the protection available to consumers should be the same regardless of the type of body delivering the services. Overall there was also consensus that regulation should be risk-based. However there was some concern about the different levels of regulation for different types of legal services providers and the risk of differences in the market, or as the Legal Services Commission described it, creating a 'regulatory maze' for consumers. On a related point the need to make the implications clear to consumers was emphasised as particularly important by one respondent. A small number commented specifically that profit should not form the benchmark for regulation. One respondent commented that LAs would in certain cases need to also consider risks around the commercial arms of special bodies. The Legal Services Consumer Panel commented that a balance would need to be struck between regulation and not limiting the ability of special bodies to provide legal services.

93. There was some comment on who will regulate special bodies. The LSC felt that it was unclear whether LAs will be required to regulate special bodies or if they can choose to regulate only mainstream ABS. The LSC also commented that within LAs, licensing special bodies, there must be clear separation of the

regulatory function from any associated representative or professional body to ensure independence and the confidence of consumers, procurers and providers. One respondent made the suggestion that the LSB should become a direct licensor of special bodies.

94. Suggestions for core requirements that all special bodies should meet included minimum levels of insurance, contribution to a compensation fund, client care and accounting procedures, first tier complaints handling, fit and proper tests, clear governance arrangements including management structures and policies, record keeping and adequate financial standards. One respondent commented that core requirements should be focused upon what is necessary for achieving regulatory objectives and maintaining professional principles.

95. There were some general comments that special bodies will need help with transition and that further discussion around the detail is needed. The Law Society commented that guidance would need to be given prior to the end of the transitional protection as to who will need to apply for a licence and what the licensing rules will be. The ASA highlighted the need for LAs to use appropriate language for those governing special bodies. The SRA stressed the importance of a decision as to whether Local Authorities should be regulated as special bodies.

96. In response to the question on whether LAs should adapt their regulation for each special body many respondents felt that whilst consistency should be achieved wherever possible, some variation would be necessary. Most respondents commenting on this point felt that this should be achieved on a case by case basis while a small number felt that in certain situations LAs should use their rules to facilitate variation for all special bodies. The ASA highlighted three specific areas that may need to be adapted for special bodies – the requirement that all non-reserved legal activities must be regulated, that at least one manager must be an authorised person and the qualifications necessary for a HoLP. Another specific comment was on local authorities and the need for flexibility if they are going to be defined as special bodies. Some respondents commented that transparency in decision making would be particularly important when decisions of variations were made for an individual special body.

97. There were mixed views on the suggestion that the Legal Ombudsman[3] should make voluntary arrangements with special bodies but the general consensus was that complaints about special bodies should come within the remit of the Legal Ombudsman. Some respondents felt that this type of arrangement could be the beginning of a transition to regulation. Others felt

[3] The Legal Ombudsman is the name by which the Office for Legal Complaints is known.

that it was unsatisfactory for consumers to be unable to complain to the Legal Ombudsman and that voluntary arrangements would be necessary as long as the transitional arrangements are in place. A small number of respondents felt that voluntary arrangements would provide sufficient consumer protection and would remove the need for special bodies to be licensed.

98. The Legal Complaints Service welcomed the regulation of trade unions providing services to non-members but warned that the distinction can be blurred, with potentially significant risks of consumer detriment. It was suggested that the Legal Services Consumer Panel considers this issue.

LSB's response

99. The LSB agrees that further discussion is needed and we will play a key role in facilitating discussions between prospective LAs and special bodies (or those who represent them). We do, however, consider that in order to protect consumers, the transitional arrangements for special bodies should be removed relatively quickly. The Act sets out what areas of licensing rules can be disapplied for special bodies. The discussions will enable us to come to a view on the appropriate way to regulate special bodies and we will consult on that view.

100. We have considered carefully how long the transitional period should remain for. We are mindful that the ABS regime will bring certain types of bodies within the scope of regulation for the first time and that time is needed for them to adapt. But we also believe that consumers of all legal services should be afforded the same protections regardless of the type of body that is providing the service. We also recognise the fact that it may create considerable additional work for LAs if the transitional provision for LDPs and other ABS-like entities, and for special bodies are lifted at the same time. In addition, many special bodies themselves will take time to introduce the requirements of ABS regulation. Our current view is therefore that the transitional arrangements for special bodies should remain for a period of 18 months after the start of mainstream ABS. We will consult on this further as part of the wider discussions about the regulation of special bodies. For technical reasons, LA's will need to state that they cannot accept applications from special bodies under section 106 until such time as the LSB issues guidance.

101. There is a need to consider who will regulate special bodies and to discuss this with the prospective LAs. The requirements for separating regulatory and representative functions apply to all LAs and so any umbrella body seeking to become a LA would have to ensure that they satisfied the Act's requirements.

102. For local authorities, the legal services that they will be able to deliver will continue to be restricted. However, we can see no reason why they should

not be able to apply under the general ABS regime, but this is for them to decide.

103. Voluntary arrangements with the Legal Ombudsman may provide an appropriate first step, but should not replace regulation. We will pursue this further with the Legal Ombudsman once it has started full operation.

Relevant guidance

Relevant paragraph in the guidance to licensing authorities on the content of licensing rules is 72

HoLP and HoFA

104. Over half of the respondents who made a submission to the consultation document commented on the HoLP and HoFA section. Of those responses to that section, the majority took a positive view on the LSB's approach with a much smaller proportion taking a partially negative view towards the LSB's approach.

105. The majority of respondents agreed that the LSB's approach to focus on compliance systems across the organisation was suitable. Shelter, the ASA and the LSC commented that reporting to the senior line of management was also appropriate.

106. Some general comments on the LSB's approach include:

- For the Law Society that governance and compliance systems are important, but the LSB or the LA should not be too prescriptive;
- The Office of the Immigration Services Commissioner said that regular checks should be carried out to ensure compliance systems work in practice; and
- RICS said that individuals that are already regulated should be treated as low risk.

107. The ASA and the LSC highlighted specific needs for not-for-profit organisations in that they will require guidance on governance and compliance systems.

108. One respondent disagreed with the LSB's approach to compliance systems and commented that the provisions in the document were 'over the top' for one person practices. The College of Law commented that compliance and ethical behaviour are 'states of mind' rather than functions of structures or systems.

109. The majority of respondents indicated that both the HoLP and HoFA should undergo a fit and proper test.

110. There were a number of comments made on the renewal period for the test, with several different scenarios suggested ranging from the test occurring as a one-off (City of Westminster and Holborn Law Society) to it being repeated every 2-3 years (OISC). ILEX Professional Standards Ltd suggested that the core information for the roles provided in the first year with reduced information sought in future returns unless there is a change in any other information, while Shelter supported a notification of change rather than renewal.

111. With regard to the requirements of a “fit-to-own” test, the Council for Mortgage Lenders emphasised the importance of consistency across LAs with additional checks built in for risky business models. Another respondent suggested that LSB should set minimum standards for competence tests. The Land Registry Office stated that test should include an appropriate level of qualification and experience to ensure there is no loss of professional legal standards and to ensure general consumer protection.

112. As to the type of precedents that could be used for the test, the Tunbridge Wells, Tonbridge & District Law Society indicated that the FSA model is appropriate with the Chester & North Wales Law Society indicating that the test should be the same as any non-lawyer manager within a firm.

113. A small number of respondents indicated that the HoLP and HoFA should not undergo a fitness to own test above the specific responsibilities that are already highlighted.

114. Furthermore, two respondents agreed for the need for a fit and proper test but were concerned that in the not-for-profit sector it may be difficult to recruit a solicitor as a HoLP with suitable experience. Some flexibility may be needed to, say, accept a solicitor with substantial pre-qualification experience but with only 2 years post qualification experience.

115. The majority of respondents indicated the need for training requirements for the HoLP and HoFA. There were a number of comments made on who should be responsible for setting training requirements with several respondents indicating that the LA should develop training programmes or set minimum standards (Irwin Mitchell LLP, the College of Law, ILEX Professional Standards Ltd, OISC) tailored to specific ABS (Association of Partnership Practitioners and ILEX). Two respondents indicated that it should be up to the owners or ABS to determine recruitment and training of HoLP and HoFA.

116. There were also comments made on specific training requirements. The SRA highlighted the need for specific training requirements that require HoLP to demonstrate experience dealing with compliance and regulatory issues at senior level to be flexibly applied. One respondent indicated that mandatory refresher training on accounts’ rules for all responsible for compliance including non-ABS.

117. Alternatively, a small number of respondents indicated that there should be no training requirements for HoLP and HoFA (City of London Law Society, the Bar Association for Commerce Finance and Industry, and the Law Society). The Law Society commented that the LA should provide guidance on expectations and that HoLPs do not have a greater training requirement as they are more likely to have experience in legal services provision. In

addition, Co-operative Legal Services suggested there should be CPD requirements rather than straight training requirements.

118. Some general comments on training for HoLP and HoFA included that training requirements should be proportionate and there should be specific training for those working in special bodies.

119. The majority of respondents agreed that the HoLP and HoFA could be the same individual. Several respondents highlighted that this was particularly relevant in a small ABS with other respondents indicating that a dual appointment should only be permitted in small ABS. The College of Law indicated that dual appointments should need mandatory evidence of accreditation, certification or education as a precondition to getting a licence.

120. However, the City of London Law Society emphasised that it was important for the HoLP and HoFA not to be the same person.

121. Two respondents suggested having a deputy HoLP and HoFA to be approved by the LA in order to step into the role if the incumbent is unable to act.

122. The Solicitors Sole Practitioners Group raised concerns over both HoLPs and HoFAs being put in a position as the "fall guy" for the failings of a commercial ABS that was more interested in profit making than meeting their regulatory requirements.

LSB's response

123. The majority of respondents indicated that the LSB's approach to compliance systems was suitable and that reporting mechanisms from HoLP and HoFA to senior management were appropriate. We think that it is vital that the HoLP and HoFA have a strong voice within an ABS, to the managers of the ABS and to the regulator of the ABS.

124. We agree with the majority of respondents who thought that the HoLP and HoFA should undergo a fit and proper test. There seems to us still to be a good argument for this to be matched, at least in form if not in judgement to the fit and proper test that is applied to non-lawyer owners and managers. While there was no consistent view on the renewal process of the test among respondents we think that a satisfactory position is for a one-off test with an ongoing reporting requirement if a HoLPs or HoFAs situation changes. Backed up with a risk-based approach we think that protection can be provided proportionately.

125. There was a strong consensus on the need for the HoLP and HoFA to have training requirements. However, while we think that training will be vital to HoLPs and HoFAs there is not a good case for uniform, compulsory training. We would expect that a poorly trained HoLP or HoFA would be banned but

we would expect that the LA would consider this as part of their risk assessment of the ABS.

126. The respondents strongly supported that option for the HoLP and HoFA to be the same person, with an emphasis that this option was well suited to smaller ABS. We agree that this must be the case to avoid artificial limitations on the business models allowed.

127. We think that unless they are demonstrably inappropriate to fulfil their role, the information about the HoLP's and HoFA's qualifications and experience should be used by the LA to inform their risk assessment of the ABS. We think that in some circumstances it may be appropriate to interview HoLPs and HoFAs prior to appointment. We also think that exit interviews may sometimes be useful for the LA to assess risk in an ABS.

128. An additional point raised by a small number of respondents was that the guidance should allow for a deputy HoLP and HoFA to undertake the roles in the incumbent is unable to act. We think that there may be situations where HoLPs and HoFAs unexpectedly are unable to continue in their role. We think that the best solution to this issue is to have a process by which ABS can inform LAs of the unavoidable breach of the Act and rules regarding how quickly the ABS must return to compliance.

Relevant guidance

Relevant paragraphs in the guidance to licensing authorities on the content of licensing rules are 12 – 13, 37 – 39, 77 – 87, 112, 114 and 116

Complaints handling

129. Most respondents were in favour of the proposals and wanted complaints handling for ABS to be the same as for non-ABS – this point was made strongly by a number of respondents. There were some comments emphasising the need to put the consumer at the centre of complaints policy. The College of Law's comments continued this theme and drew some distinction between ABS and non-ABS by saying that the approach to complaints handling by 'new entrant' ABS might potentially be more consumer friendly and helpful. Nonetheless, they also shared the view of most respondents that formal mechanisms for first-tier handling of complaints should be consistent between legal services but that there might by scope to allow ABS to adopt their own complaints handling process. Co-operative Legal Services said many customer organisations already have sophisticated complaint management processes in place. They also said that complaints handling could be built around other requirements such as the FSA framework.

130. The Solicitor Sole Practitioners Group made the point that the potential complexity of an ABS structure in respect of non-regulated services should not be passed to consumers through a difficult to navigate complaints process. However, the Association of Partnership Practitioners commented that ABS should be allowed to adapt their own complaints handling systems if they already had one for their non-legal services consumers, provided it met the reasonable requirements of the LA. ILEX echoed this view.

131. One respondent said that if ABS activities are distinct from the rest of their owner's activities, the regulatory and complaint handling structure should cover the non-reserved legal services they provide as well as the non-legal. Shelter added that ABS should be permitted to continue with internal complaints structures where they existed although ARs should lay down minimum standards for internal complaints and a consistent approach.

132. There was general agreement that the proposal that the Legal Ombudsman should take complaints from multi-disciplinary practice consumers and refer where necessary. They expressed the view that it was not the job of the consumer to assess the most appropriate venue for a complaint and that the Legal Ombudsman would be ideally suited to act as a filter in those circumstances.

133. Another suggestion was that the role of the Legal Ombudsman with respect to each 'special body' may need to vary depending on the complaints handling process in place.

134. ICAEW pointed out that there could be issues for existing MDPs and non-legal providers with existing complaints frameworks. They said that the

reserved legal element could be a very small part of the business. They cited an example where referring a complaint about audit, might be counterproductive. They suggest that a complaint should instead be referred to the LA and if a matter was related to legal services it should then be forwarded to the Legal Ombudsman.

LSB's response

135. We note that most respondents are of the view that complaints handling by ABS should be treated the same as non-ABS. We are also of this view. There should not be significant differential between the way in which ABS deal with complaints and non-ABS. The key desired outcome, as expressed in the consultation document is that consumers of legal services provided by ABS must be afforded the same protections as consumers from non-ABS providers.

136. We share the view that some 'new entrant' ABS might potentially be more consumer friendly and helpful because of the more diverse nature of the service provision and management structure but would not want to imply that non-ABS are somehow less consumer focussed. But there may be lessons ABS can learn from non-ABS and vice-versa.

137. We agree that consistency of first-tier complaints handling across legal services is a high priority. The wider work the LSB is doing with ARs to improve first-tier complaints handling through the setting of key outcomes for consumers will be a crucial pathway for ensuring ABS in-house complaints handling is of a higher standard. Any guidance issued on complaints would need to apply to ABS as much as non-ABS.

138. With regard to adapting complaints handling systems if one already exist for non-legal services consumers, provided it an approach which is likely to benefit consumers we see no reason why this should not happen. However, our view is that managing complaints is an important part of consumer protection and will form part of regulatory arrangements required for licensing. Consequently, we would expect any existing non-legal complaints system adopted by an ABS to meet the LA's guidance on first-tier complaints handling.

139. We have noted the general agreement with the proposal that the Legal Ombudsman should take complaints from MDP consumers and refer where necessary. It is clear, as reflected in the consultation document, that we need to ensure that potential for complexity of complaint handling for MDPs does not have an adverse effect on the consumer. The proposal for the Legal Ombudsman to act as a 'clearing house' for complaints relating to non-lawyers will simplify the process from a consumer perspective rather than referring it via the LA as was suggested in one of the consultation responses.

We think that is vital that consumers of ABS must have equal access to the Legal Ombudsman as other consumers.

Relevant guidance

Relevant paragraphs in the guidance to licensing authorities on the content of licensing rules are 24 – 25 and 59

Diversity

140. Around half of the respondents who made a submission to the consultation document commented on the diversity section. Of those who responded the majority took a positive view on the LSB's approach with a much smaller proportion taking a negative view towards the proposals.

141. A large majority of respondents indicated that the LSB should require information about the diversity of the workforce in ABS. A smaller proportion thought that this should be a requirement for ABS and all other legal service providers. However, there were several concerns highlighted, they include:

- The requirement to not impose excessive burdens on resources and cost on either not for profit or smaller approved regulators (the ASA & the Faculty Office)
- That responsibility for collecting the information should be for the LA and not LSB (ILEX)
- That there was a clear explanation of the what will be done with this information so not to create a regulatory burden (ILEX Professional Standards Ltd)
- That anonymity and confidentiality must be guaranteed

142. Respondents commented on the timeframe of when the requirement should be introduced with some indicating that it should be introduced as soon as possible (OISC) or at the application stage (Motor Accident Solicitors Society). Other respondents thought it should not be imposed immediately (Irwin Mitchell LLP) but developed with more experience (SRA) or introduced at a later date e.g. in five years time (the Bar Association for Commerce Finance and Industry).

143. A much smaller proportion of respondents indicated that a requirement for diversity information should not be imposed with one respondent indicating it was 'too much micromanagement from the LSB'.

144. The Legal Services Consumer Panel was in favour of a requirement for ABS to have a specific outcome aimed at increasing diversity of consumers accessing legal services.

145. The majority of respondents agreed with the LSB's position that there were a range of positive benefits to the introduction of ABS that would in turn have a positive effect on diversity of the profession. The benefits highlighted include:

- New management roles (Council of HM District Judges (Magistrates' Courts) Legal Committee)

- Enhancing employment opportunities through different business models (Chester and North Wales Law Society and the Association of Partnership Professionals)
- Introducing more flexible training (the Bar Association for Commerce Finance and Industry)
- Facilitate different career paths (SRA, Co-operative Legal Services)

146. However, other respondents stated that the introduction of ABS would have an adverse effect on diversity of the profession (BSB, Solicitors Sole Practitioner Group). The main concerns were that:

147. The positive implications listed in the consultation paper were not based on evidence and data on the subject should be gathered to benchmark the composition of the workforce in order to monitor impact of changes (BSB).

148. There is some evidence to suggest 'market forces undermine opportunities for carers and those with limited mobility' (The Law Society).

149. Several respondents emphasised the importance of continued monitoring of the impact of ABS on diversity (BSB, Chester and North Wales Law Society, OISC, SRA).The Law Society strongly advised the LSB to undertake a full equality impact assessment.

150. The BSB and the Law Society highlighted the importance of public authorities' public duty to gather evidence in relation to equality and diversity when making major policy decisions.

151. The majority of respondents indicated that non-lawyer career paths may open up more opportunities for lawyers in particular in term of career progression (ILEX, ILEX PS, Irwin Mitchell LLP, Motor Accident Solicitors Society, and Co-Operative Legal Services). Other respondents were less convinced including the College of Law and the Law Society who indicated that lawyers already have 'extensive career options'.

152. There was no consensus on the impact on small firms and whether there would be a consequential impact on diversity. Three respondents indicated that they thought that the demand for diversity will offset the closure of small firms. However, an equal number of respondents indicated that the demand for diversity did not offset the potential impact due to the closure of small firms.

153. Two respondents indicated that they have major concerns about the closure of small firms and the negative impact this may have on disadvantaged clients (Council of HM District Judges (Magistrates' Courts) Legal Committee and the Faculty Office). The SRA and Tunbridge Wells, Tonbridge & District Law

Society thought more research into the issues was needed. Some thought that the closure of small firms was not inevitable and that small firms may stay open or increase as part of ABS by virtue of costs savings.

LSB's response

154. Many respondents agreed that the impact on diversity needed to be carefully monitored. The LSB fully endorses this conclusion. To evaluate the impact, however, we need to have comprehensive data on the starting position. We will therefore continue to work with ARs and other stakeholders to boost transparency at the level of individual entities and professional groups in order to provide a baseline against which the impact of ABS can be measured, both in terms of workforce composition within ABS entities themselves and changes in the wider legal workforce to which ABS will contribute.

155. The majority of respondents indicated that they would support a requirement for diversity data but that this requirement should be proportionate, i.e. not over burden organisations that have little resources such as smaller ARs and not-for-profit sector. We agree that any request for information must be proportionate. We think that the introduction of this proposal needs to be informed by research and experience.

156. Respondents acknowledged and agreed that there are a number of potential benefits to diversity associated with ABS. However, not all respondents agreed with the position and were concerned that some of the positive implications highlighted in the report were not backed up by evidence. Measuring the benefits will always be difficult, however, we will be undertaking further work to consider the impact of ABS.

157. In general, the potential benefits of non-lawyer managers opening up new career paths were recognised and supported. We think the introduction of ABS should make career paths for lawyers and non-lawyers who work in legal service more diverse.

158. In terms of closure of small firms, there was a mixed response with no clear majority indicating that the increase in diversity would or would not offset the potential impact of the closure of small firms. It is acknowledged that there is a concern among respondents about the impact of disadvantaged or BME groups due to small firm closures. However, responses indicated that equally, there was no substantial evidence to say if small firms would close as a result of the introduction of ABS. Overall, we agree that more research is needed on the subject.

Relevant guidance

Relevant paragraphs in the guidance to licensing authorities on the content of licensing rules are 26 – 27 and 40.

International issues

159. Just over half of the respondents did not provide a response to this policy issue. Of those who did, respondents were almost split evenly between supporting and not supporting our position.

160. Key themes from the respondents who did not support the LSB's position were:

- The unlikely success of implementing ABS internationally given that many international professional bodies do not support the ABS/MDP concept. As a result, it may present obstacles for firms wanting to adopt the ABS regime.
- Some of the smaller international regulators may not have the capacity and/or capability to establish a domestic and international ABS regulatory framework. There was particular concern regarding the robustness and effectiveness of the international regulators' enforcement powers and their ability to maintain consumer safeguards.
- That there will be international interest to see if the implementation of ABS in England and Wales will work and achieve its stated outcomes. Therefore, the focus of the LSB should be on ensuring that ABS works in England and Wales first before expanding it internationally.
- Allowing ABS will undermine the integrity and professionalism of some professions.
- That the LSB should not be spending money on awareness campaigns overseas.
- The possibility of organised crime undermining the ABS, and thus, the reputation of the English and Welsh lawyers.

161. Key themes of those who did support LSB's proposals were:

- The LSB should engage and communicate with international professional bodies and governments to promote the success of the ABS regime.
- Saw merit in the approach as its members already operate internationally.
- Wanted to know more what the LSB's intention "to work with other jurisdictions to inform them about the ABS framework and protection" and that other issues, such as international regulatory overlap/gaps, needed to be resolved before the LSB's position is fully supported.

LSB's response

162. We have decided to remove the international outcomes from the list of outcomes for ABS. We are still of the view that in the interest of the legal services market generally there must be an international dimension. Legal Services are, after all, a significant part of the United Kingdom's exports. We will work with interested parties to develop a strategy that balances the need to be outward looking with the need to ensure that our approach is effective.

Relevant guidance

Relevant paragraphs in the guidance to licensing authorities on the content of licensing rules are 96 and 128.

LDPs and Recognised Bodies

163. The majority of respondents did not address the question of LDP and Recognised Bodies transitional arrangements. However, of those that did, most were generally supportive of the proposals, particularly that a 12 month transition was adequate. The Law Society said it should be no longer than 12 months to ensure that the end of the transition does not coincide with the end of the transition for special bodies which they proposed be longer. It did not believe this would pose a regulatory risk as LDPs would continue to be licensed. One contributor said that the number of LDPs that have been authorised was sufficiently small to be managed within a 12-month window.

164. The College of Law commented that even if there is a transitional period, any given firm would not be precluded from applying for a licence before the end of that transitional period.

165. The City of Westminster and Holborn Law Society said it was too early to state definitively what time period may be required. They were also not convinced that it is was necessary for LDPs to become ABS arguing that the requirement that all solicitors' firms apply for recognition is sufficient to address any risk presented by those LDPs which have a non-solicitor manager.

166. The SRA said it would like more clarity on the proposal so that it can work out what it means in practical terms, i.e. would the enforcement provisions in the LSA make sense against the current regulatory framework for LDPs.

167. One respondent proposed that the LSB might form a stakeholder group and work closely with the regulators about the timescales for implementing a regulatory system. It was suggested that this might allow time for the risks to be properly considered and the regulatory framework put in place to mitigate those risks.

LSB's response

168. We note that there were no responses that significantly disagreed with the proposals on LDP and Recognised Bodies – in particular the 12 month transition. We are still of the view that where existing bodies have no choice but to become licensed as ABS there should be a transitional period. We would expect LAs to have in place mechanisms where these bodies could apply before the transitional protection ends. We note that since the publication of the consultation document the SRA and CLC have indicated that they will be adapting their general rules so it may be that LDPs and other similar bodies will see a change in their regulation regardless of whether they become ABS earlier than the end of the transition period.

169. We also recognise that other bodies, such as those regulated by the Intellectual Property Regulation Board (IPREG) face the same issues. The Act does provide a transition mechanism for these bodies too and we will work with IPREG to ensure that the transition is as effective as possible.

170. We recognise that further clarity might need to be provided by the LSB for the SRA and CLC in respect of the practical implications of the transition. We will work with ARs to address these detailed issues in the ABS implementation group.

171. We had proposed that a LA should grant a LDP and other ABS-like entities a special class of licence that would replicate the regulatory framework for non-ABS entities. That licence would last for 12 months during which time the entity could apply for an ABS licence or revert to a structure that would not need to be licensed. The proposal was based on the understanding that it was unlikely that there would be major changes in the regulatory arrangements of ARs and it was therefore desirable to regulate all ABS (including those LDPs who were in effect ABS) under the Act's provisions rather than have separate legal frameworks for different types of ABS. Since then, the SRA has stated that it intends to change its regulatory arrangements so that there is one handbook containing all the regulatory requirements for ABS and non-ABS firms.

172. The Act provides transitional arrangements for LDPs that are recognised bodies under the Administration of Justice Act 1985 and would otherwise need to be licensed from the start of ABS. Those transitional arrangements can be brought to an end by the Lord Chancellor on the recommendation of the LSB. Given the changes that have been announced by the ARs most likely to become LAs and the progress made so far, it seems appropriate to use the mechanisms in the Act to end the transitional period 12 months from the start of licensing ABS.

Relevant guidance

Relevant paragraphs in the guidance to licensing authorities on the content of licensing rules are 28 and 131

Term of licences

173. Approximately half of respondents made comments on this section, of those who did respond most were supportive of the proposals.

174. With the exception of two respondents, all support the concept of indefinite licences on the basis that the LAs will have the power to revoke licences if standards are not met. The Solicitors Sole Practitioners Group proposed that licences should be renewable on an annual basis in line with the existing recognised bodies. ILEX suggest that this should be a matter for the individual LAs to decide – if the LSB is satisfied that consumer protection standards are being met, then we should not inhibit how licences are issued and for what period.

175. There was wide support for cost reflective fees and that different fees may be charged to different bodies. Shelter noted that one possible outcome is that 'low-risk' ABS could subsidise higher risk (and therefore higher fee earners) organisations, reflecting the view that fees need to be fair to all fee payers (at least of a particular licensing authority).

176. Many accepted that the requirement to notify the licensing authority of any changes should mean that annual checks are not necessary. There were, however, a number of respondents who expressed reservations as to whether the requirement to notify was a sufficient safeguard and whether there should be some form of "annual return" ranging from

- Annual confirmation that there have been no changes (perhaps linked to fee invoicing and payment)
- Annual accounting returns, business management and regular statistical returns
- An annual entity based return

177. Whatever approach is taken respondents thought that effective monitoring is necessary to act as a deterrent on failing to report changes. The LAs may need a range of tools (spot-checks, ad-hoc requests for information, on-site inspections, penalties for failure to notify) to test this.

178. The OISC view is that notification is not sufficient and that there should be regular checks of ABS firms.

179. The SRA expressed the view that appeals against revocation decisions should be dealt with by the appellate bodies rather than by judicial review as proposed in the paper.

LSB's response

180. On the basis of the predominantly positive feedback, we intend to proceed with the proposals on indefinite licensing periods and cost reflective fees.

181. While we believe that the notifications should mean that annual reviews are not needed, we recognise that we need to demonstrate that this is effective and that this will contribute to the consumer confidence objective. However there is a likely to be a diverse range of ABS firms and therefore it is probably most appropriate for each LA to determine its own requirements to ensure that the requirements are proportionate.

Relevant guidance

Relevant paragraphs in the guidance to licensing authorities on the content of licensing rules are 64 – 71

Managing Regulatory Overlaps

182. Most respondents agreed that it was sensible to put in place a mechanism to resolve overlaps and conflicts between regulators. Many commented on the importance of reducing uncertainty for consumers. For example, the Land Registry Office commented that confusion for consumers needed to be minimised in order to provide consumer protection and redress. The LSC observed that consumers have problems in identifying the standards of professional service before purchase.

183. There were several comments supporting the principle of a framework Memorandum of Understanding (MoU). For example, the Legal Services Consumer Panel said that regulatory overlaps will need to be managed and should be done through a MoU. They suggested that the LSB should encourage cooperation with other redress schemes as well as other schemes for consumer complaints. The College of Law agreed that a framework approach to a MoU is sensible. They considered that transparency and consistency between regulators is important, as well as avoiding unnecessary burdensome compliance costs for ABS offering multiple services.

184. However, there were also concerns about a MoU expressed by some respondents. For example, the Liverpool Law Society expressed doubt about the adequacy of MoU in relation to MDPs. They believed that there were echoes of the unsatisfactory situation that developed under the Financial Services Act 1984, when different parts of the same firm could be regulated by different regulatory bodies. RICS said that they did not think a single MoU could be effective in the numerous business structures that currently exist and which may arise. The Faculty Office was particularly critical, saying that a MoU would be a further layer of bureaucracy with potential financial consequences and that it would be preferable to see whether there were regulatory overlaps to be tackled.

185. ILEX observed that the bodies identified in the consultation appeared to cover the main bodies regulating people with whom a lawyer is likely to form an ABS. But the list of bodies may need to develop over time as ABS is formed with other regulated individuals. They were also of the view that a MoU should include overlap of codes of conduct and regulatory requirements.

LSB's response

186. We note that many respondents were in general agreement with the need for a single framework MoU. However, there were also some issues and concerns expressed that the LSB needs to consider further. For example, in relation to MDPs, whether a MoU can adequately deal with any overlapping codes of conduct or other regulatory requirements. The LSB will take account of these comments and consider further how to make the MoU framework

work in a satisfactory way to deal with different business models, minimising burdens but ensuring consistency and the protection of consumers.

187. As we said in the consultation document, we expect the MoU to allow for different risks in different businesses to be regulated in different ways by regulators, and that this may change over time as different levels of risk are identified and experience of compliance develops.

188. Since the publication of the consultation document the SRA have indicated that will lead the facilitation of the agreements required to deal MDPs.

Relevant guidance

Relevant paragraphs in the guidance to licensing authorities on the content of licensing rules are 29, 36 and 58

Annex A: Respondents to the consultation document.

Association of British Insurers
Advice Services Alliance (ASA)
Association of Partnership Practitioners
Bar Association for Commerce Finance and Industry
The Bar Council
The Bar Standards Board
Beachcroft LLP
Bevan & Brittan LLP
The Land Registry Office
CCBE
Chester & North Wales Law Society
Citizens Advice Bureaux
The College of Law
The Communication Workers Union
The Council for Licensed Conveyancers
The Council of HM District Judges (Magistrates' Courts) Legal Committee
The Council of Mortgage Lenders
Faculty Office on behalf of Master of Faculties
Hertfordshire Law Society
The Institute of Chartered Accountants for England and Wales (ICAEW)
The Institute of Chartered Accountants for Scotland (ICAS)
The Institute of Legal Executives (ILEX)
ILEX Professional Standards Ltd
Irwin Mitchell LLP
The Judicial Appointments Commission
The Legal Complaints Service
The Legal Services Commission
The Legal Services Consumer Panel
Liverpool Law Society
Lucy Scott-Moncrieff
The Master of the Rolls
Motor Accident Solicitors Society
Office of the Immigration Services Commissioner
Onsagers Ltd - confidential response
Richard Barnett
The Royal Institute of Chartered Surveyors (RICS)
The Solicitors' Disciplinary Tribunal (SDT)
Shelter
The Society of Scrivener Notaries
The Solicitor Regulation Authority
Solicitor Sole Practitioners Group
The City of London Law Society

The City of Westminster and Holborn Law Society ('CWHLS')
The Co-operative Legal Services
The Law Society
Tunbridge Wells, Tonbride & District Law Society