Irwin Mitchell's Response to the LSB Consultation Paper on ABS: Approaches to Licensing

1. As a major National firm providing a wide range of legal services to consumers of all kinds, Irwin Mitchell has taken an active interest in the post Legal Services Act (LSA) regulatory reforms and, as a supporter of the general thrust of the LSA reforms, has responded to all consultations since the first report by Sir David Clementi.

2. Our response to this consultation paper also takes into account our response to the LSB consultation "wider access, better values, strong protection".

3. As we set out in that response, we believe that regulators of the legal profession should behave in a manner that is proportionate, fair and reasonable, coupled with a clear understanding of the commercial drivers likely to influence practitioners as they face up to the most significant challenges and changes in the legal services market for generations. We welcome the greater flexibility inherent in the proposed outcomes-based approach and the move to a more risk-based approach by the licensing authorities (LAs).

Q1. What is your view of basing the regulation of ABS on outcomes?

a. Should all LAs have the same core outcome?

As discussed in para 55 the aim should be that the same set of regulatory outcomes should apply to all LAs. The flexibility to determine how to meet those outcomes, as referred to in para 52 in relation to an ABS, should apply in the same way to LAs. This appears to be the thrust of paras 56 to 58 which we support as an analysis of how outcome based regulation would work in practice for different LAs.

b. Are the proposed outcomes appropriate?

The proposed outcomes set out in para 37 are comprehensive and are analysed in detail in the remainder of the consultation paper so we will address the detail in our responses that follow in relation to the relevant sections. However, as a general question of whether the list of proposed outcomes in para 37 is 'appropriate' (it may also be useful to consider whether any items in the list are 'inappropriate') we would say that the contents of the list seem to strike the right balance of core outcomes that should be adhered to by a regulated entity/individual or LA. The proposed outcomes appear to reflect the policy and spirit of the LSA as well as its statutory provisions. The LSB may wish to emphasise the

importance of the LSA as the underpinning of the proposed outcome by referring to the regulatory link between the regulatory objectives (Section 1), the duty of an AR to promote the regulatory objectives (Section 28) and the duties of regulated persons to comply with the regulatory arrangements of the AR (Section 176).

The only other specific comment we would make on the list of proposed outcomes is under the section headed 'Reserved and non-reserved legal services' (page 12) where we suggest the additional wording:

- LAs provide the same levels of regulation to ABS in relation to reserved and non-reserved legal services.

c. Is the division between entity and individual regulation appropriate?

The discussion and analysis in paras 52 to 68 is illuminating and helpful. The diagram at Annex A on page 92 is a particularly good illustration of the areas of potential conflict between entity and individual regulation. It might be helpful to illustrate the regulatory overlaps (no longer a maze) as a diagram (as Clementi did) as well as in narrative form on page 89.

We wish to make some specific comments on paras 62 & 63. It seems to us that bullet points 1 to 4 in para 63 should fall within the category of entity level considerations in para 62 because they (or substantial elements of them) are central to the efficient running of a business and if unattended to properly could have a detrimental effect on the way that an ABS looks after the interests of its clients. This is less so with bullet point 5 which is purely business development focussed. On that note we would suggest that the list of considerations in para 62 should be expanded to include the following additional items:

- Adherence to the LSA regulatory objectives
- Risk management
- Internal audit
- Quality of service standards
- Diversity policy
- Social responsibility policy

Q2. Do you think our approach set out in this chapter to the tests for external ownership is appropriate?

a. Should the tests be consistent across all LAs?

Yes.

b. Is our suggested approach to the fitness to own test the right one?

Generally, the proposals and guidance in relation to the fitness to own test are the right approach, as set out in para 87.

With regard to para 93, we believe that management competence, whilst not a conclusive matter for or against fitness to own, is a factor worth including in the list of considerations when measuring fitness to own. A non-lawyer who has excellent management competence could improve their 'fitness to own' mark/assessment when applying to become a partner/shareholder in an ABS. The Australian self assessment method seems to be working and is attractive but awareness of management competence of a proposed owner of an ABS is a valuable piece of knowledge about an applicant.

c. If declarations about criminal convictions are required should these include spent convictions?

This is not an easy question. In criminal law the purpose of a spent conviction is to ensure fairness on sentencing if a convicted person has a record of previous but aged convictions that are deemed to be too old to be taken into account. This is a different consideration from an employment law situation where a would be employee is seeking a position of trust involving responsibility for client monies. The same applies for the would be non-lawyer owner of an ABS. The Solicitors Code of Conduct and most partnership deeds contain penalty provisions for a solicitor who is convicted of a criminal offence. The assessment of integrity as part of the fitness to own test and the need for trust in all dealings within the ABS are so high that on balance we believe that even a spent conviction should be declared.

d. What is your view of our suggested approach for considering associates? Is there an alternative approach that would work better in practice?

This is an important and potentially complex area of the licensing rules. We support the approach of avoiding complexity, analysed and assessed very well in paras 94 onwards. It is important that the requirements of the fitness to own test are not so complicated as to cause undue delay in dealing with applications or even to become a disincentive to "fit and proper" proposed investors. With regard to the additional approach in para 106 we suggest that some comfort about the lack of improper influence of external investors can be obtained from the example of 'third party' litigation funders who have become a well established feature of large commercial litigation cases without accusations of improper interference in the litigation process.

A balance needs to be maintained between having clarity as to who will be an Associate so that an owner of an ABS has a clear idea of who is the owner's Associate on the one hand and leaving the meaning of the term more vague so as to encompass all possible sources of unwelcome influence. Perhaps there would be merit in having an approach similar to that taken by the Panel on Takeovers and Mergers in the Takeover Code in which the definition of "Associate" begins:-

"It is not practicable to define associate in terms which would cover all the different relationships which may exist …"

The definition continues by giving examples of the kind of relationship where a person may be an associate.

Apart from our anxieties regarding the possible complexity of running the "fitness to own" test for Associates of a larger corporate owner with many companies in its Group, we have concerns of the difficulties that may emerge when, and surely this will happen, there is a change in the identity of the Associates of a larger corporate owner who is a licensee because these changes would be notified to the LA and, where appropriate, the "fitness to own" test would need to be carried out.

One issue in relation to Associates is that although paragraph 5(2) (g) of Schedule 13 of the LSA and paragraph 96 of the Consultation Paper refer to subsidiary undertakings and their employees and directors being Associates, no mention is made of parent or holding companies of the ABS or the person taking a material interest in the ABS

e. Should there always be a requirement to declare the ultimate beneficial owner of an ABS?

We consider that it would be helpful for the ultimate beneficial owner of an ABS to be declared; the information is no secret because it will be disclosed in the ABS's financial statements. Apart from dealing with the group perspective of applicants, such information may also help to flush out nominee holdings.

A different question is whether the ultimate beneficial owner of the holder of a material interest ABS should also be disclosed.

We believe that the identity of an ultimate beneficial owner of an ABS and of those holding material interests in an ABS should be readily available for the public in much the same way as law firms have to make available the names of their partners/members. This information might be of great importance to potential clients of the ABS or those having other dealings with it.

f. Overall, are any modifications needed to ensure that our approach works in a listed company?

Paragraph 73 of the Consultation Paper calls for a listed ABS to make a clear statement in its constitutional documents of the regulatory duties applying to it. We believe that all stakeholders in an ABS, listed or not, should be aware of the anticipated regulatory obligations arising from its being a regulated services provider and perhaps the listing particulars and the annual financial statements would be an appropriate place for information regarding this issue to be given.

We would not be in favour of provisions regarding regulatory compliance being contained in the Memorandum or Articles of Association of any corporate ABS as we do not believe that a company's duties to its shareholders will compromise obligations to comply with regulations. The shareholders can always change the constitutional documents and such a provision would not of itself prevent shareholders acting wrongly if that is what they want to do. If the ABS does not act in accordance with the regulations, whether or not this lack of compliance is at the behest of the shareholders, the consequences will be apparent to them and their Board. By way of example it would not be normal for a Banking Company to refer to its regulatory obligations in its Constitutional Documents although these may be numbered amongst a risk analysis either in Listing Particulars or in financial statements.

g. Overall, are any modifications needed to ensure that our approach works in very small companies?

We believe that the approach works equally as well for very small companies. There is, perhaps, less need for the inherent regulatory risks to be disclosed to these shareholders (see (e) above) than for a company with many shareholders because the shareholders of a small company are more likely to know this detail.

However, we believe that the disclosure to the public, including the ABS's clients, of the ultimate beneficial owners first of the ABS and secondly of all those holding a material interest in the ABS, would equally benefit those dealing with a small ABS as those dealing with a large one.

h. Do you think that the definition of restricted interest should change?

No.

i. Do you think that covenants should be required from those identified as having a significant influence over an ABS?

No. Covenants would increase complexity and it is not clear who would have the benefit/burden of the covenant.

j. How should the LSB respond to the information it receives about information on action taken against people that falls short of disqualification.

This is very difficult to achieve in general terms. The LSB will need to devise a transparent and consistent policy as a good oversight regulator. The same should apply to LAs.

Q3. Do you have any views on how indemnity and compensation may work for ABS?

a. How should an appropriate level of PII be set for ABS that are carrying out a variety of different activities, not all of which are currently regulated by the ARs?

Arguably the approach should be the same as currently applies. Many law firms already carry out a mixture of work that is reserved and unreserved. As law firms and individuals they are subject to regulation even though the unreserved activities can be carried out by competing and unregulated non-lawyer commercial organisations. It is hard to se why the level of PII

should be any different because a law firm is operating as an ABS and carrying out the same activities as before, reserved or unreserved. However, if a licensed ABS intends to carry out entirely new unreserved legal activities or non legal activities that could pose higher consumer risk it should be required to make that clear under the terms of its licence. If necessary, the LA should be able to prescribe a higher level of PII to reflect additional risk to the consumer if the existing level is thought to be inadequate.

b. Should there be minimum PII levels which are the same for all LAs for different types of activity?

A minimum level of PII across all LAs, on a 'one size fits all' is not realistic since the regulated entities/individuals by different LAs are so varied. Each LA should set its own minimum level which provides adequate consumer protection for all those that it regulates. Consistent with the answer in 3a above, where an ABS is involved the LA should be able to set a higher level if a particular activity poses a particular risk higher than the minimum level. In practice, most large firms have PII cover in any event. Presumably, the current list of qualifying insurers and/or the ABI would have data on this.

c. Are master policy arrangements appropriate for ABS?

We cannot envisage that this would be appropriate. The advantage of departure from the old SIF merger policy was that firms could be charged PII premiums according to their nature of work and level of risk, allowing for differentiation. One size did not and does not fit all in this area.

d. What would be appropriate arrangements for run off and successor practices to enable sufficient commercial freedom for ABS as well as protection for consumers after practice closure?

Paras 141 to 145 raise issues that the PII market is best qualified to answer. For our part we have difficulty with the suggestion in para 144 that an SRA regulated firm that becomes an ABS amounts to a practice closure and run off situation. We would anticipate that the pre ABS firm will, at least initially, carry on its business in the same way as post ABS. There should be a seamless transition from one to the other without a cessation of existing practice and start up of another practice structured as an ABS. If we are wrong about this we would urge reconsideration of the interpretation of the LSA because we doubt whether this point has been generally understood in this way. There might well be serious taxation implications on cessation and start up. Has the LSB considered

the taxation issues for firms intending to become ABS (particularly by way of IPO) in case there are disincentives/barriers that would inhibit the opportunities for ABS start up in 2011? There may need to be discussions between the LSB and HMRC on these issues.

e. What should the requirements be for compensation funds in ABS?

We note (para 149) that a task force is to be set up and rely on it to produce definitive answers. For our part, we believe that an ABS should be required to contribute to the same compensation funds as already exist without introducing the complexity of new funds peculiar to ABS only.

f. How could a compensation fund work in an ABS environment, in particular when the services offered by the ABS may be much wider than legal advice and where an AR may not currently have a compensation fund?

On a case by case basis, each ABS should be reviewed having regard to the activities it carries out. If a new activity, legal or non legal, reserved or unreserved, poses particular risk then, as with our answer on PII matters, the LA should be able to adjust the level of contribution to the compensation fund. Great care would be necessary in doing this so that it does not become a financial penalty that discourages innovative activity.

Q4. Do you agree with our position on reserved and non-reserved legal activities?

a. Do you agree that ABS should be treated in a consistent way with non-ABS?

Yes, as far as possible, to ensure that there is no competitive disadvantage either way. The often talked about "level playing field" would be unlevel if:

- A firm of solicitors becomes an ABS and is regulated by the SRA in respect of all its activities (reserved and unreserved) but has to compete with a non ABS non-lawyer commercial organisation that carries out unregulated unreserved legal services.

- Solicitors' firms that are considering ABS in 2011 find themselves behind the pace because of the restrictions of the SRA in the lead up to ABS, compared with the unregulated freedom of preparation (even operation) of non lawyer

commercial organisations that have unlimited funds to compete in a market where solicitors are still prohibited from obtaining external capital.

b. Should all legal activities undertaken by an ABS be regulated or just reserved legal services?

An ABS should not be regulated more widely than a non ABS. If the historic (para 162) distinction between regulated and unregulated legal activities is to remain (we agree that this warrants consumer research) the options are (i) to regulate reserved legal activity only or (ii) to regulate reserved and unreserved legal activity. Whichever option is ultimately decided upon the same regulatory regime should apply to ABS and non ABS. We add that we are strongly in favour of will writing being brought within the list of reserved legal activities if it would otherwise remain unregulated as an unreserved activity, as at present.

c. What role do you see consumer education playing?

The opinion and knowledge of the consumer is extremely important and should be taken into account consistently with the spirit of the LSA. If para 164 is correct (we think it is) arguably the historic distinction between reserved and unreserved legal activities should be removed. If that were to happen the only regulatory route would be to bring into regulatory scope all legal activities, reserved and unreserved. If this is what the consumer believes is already the case that is persuasive. The recent consumer research which showed that 67% of consumers think that all will writers are solicitors is, we believe, indicative of the current level of knowledge of the consumer (page 2 (web news) of the Law Society Gazette 04/02/10). Just one example of unreserved and unregulated legal activity causing consumer detriment is the behavioural history of some claims management companies. Although the CMCs are now regulated by the MOJ it was in the unreserved area of legal activity that they were able to take advantage of consumers by settling personal injury claims without issuing legal proceedings (a reserved activity). We believe that this special area of CMC regulation by Government should be transferred to the LSB and the ARs together with any other areas of unreserved and unregulated legal activity. This would maximise consumer protection and minimise the need for consumer education which will be difficult to communicate in such a complex area.

d. How should ABS which are part of a wider group of companies be treated?

The fact that an ABS is owned or part owned by an external investor that owns other non ABS non legal service companies as a group should not affect the regulatory regime/licensing conditions for the ABS. As long as the HOLP and HOFA are in place and as long as the scope of the ABS's activities are understood in terms of regulation (reserved or unreserved) there should be no fear of consumer detriment or other risk merely because the ABS is also part of a wider group.

Q5. Are the enforcement powers for LAs suitable?

a. What is your view on the proposed maximum level of financial penalty that a LA can impose on an ABS?

The proposal that the maximum financial penalty should be unlimited (paras 174 and 201) seems harsh at the outset of a new regulatory regime even if it also has to be proportionate. The current ability of the SDT to impose an unlimited fine on an individual is a useful comparator but an unlimited maximum financial penalty on an ABS entity could be seen as a harsh disincentive to those wising to enter into a completely new area of business structure where there will be a learning curve for everyone. We would prefer to see, if possible, some calibration of levels of financial penalty linked to various categories of failure/breach, perhaps identifying the extreme areas of failure deserving unlimited penalty.

b. If you do not consider the proposed maximum to be appropriate what amount or formula would you propose?

See 5a above.

c. Will LAs have sufficient enforcement powers?

Appropriate steps should be taken to ensure that they have.

d. Will ABS have sufficient clarity as to how the enforcement powers may be used?

Appropriate steps should be taken to ensure that they do have sufficient clarity.

e. In what circumstances should a LA be able to modify the terms of a licence?

The answer to this question is inevitably speculative because it is hard to foresee as yet what the terms of a licence will look like. No doubt in the early days of ABS the LA will consider the terms of a licence at each renewal/review (assuming that there is one). Any proposed modifications should be based on clear evidence and sensible dialogue with the ABS rather than diktat from the regulator.

f. Are there appropriate enforcement options for use against non lawyer owners?

The licence terms and the regulatory framework surrounding an ABS should make it clear that in an ABS non lawyer owners are subject to the same enforcement procedures as lawyer owners.

Q6. What do you think of our approach to access to justice?

a. Do you think the wide definition of access to justice that we have taken is appropriate?

Yes. Indeed, we support the general thrust of the arguments, explanations and provisional conclusions in paras 215 to 223.

b. Is asking an ABS on application how they anticipate that they will improve access to justice a suitable approach?

This is certainly a reasonable question to ask having regard to section 85(5)(b) of the LSA. Some guidance may be necessary to assist applicants on the threshold they may be required to reach to satisfy the LA that it has carried out its licensing responsibilities under S.85(5)(b). This is just one reason why a wide definition is appropriate.

c. Do you agree that restrictions on specific types of commercial activity should not be put in place unless there is clear strong evidence of that commercial practice causing significant harm?

Yes.

d. Do you agree that LAs should consider how ABS in general impact access to justice rather than trying to estimate the impact of each application singularly?

No. LAs should be prepared to do both. As a licence condition in S.83 (5) (b) the LA should consider access to justice per each application but should also (for its own knowledge & research purposes) consider the overall contribution to access to justice by ABS generally.

e. Do you agree that LAs should monitor access to justice?

Yes, but only on the occasion of annual renewal/review of a licensed ABS (assuming that a renewal/review will be required). Ongoing monitoring would impose an unreasonable burden on LAs especially because measurement of access to justice is not an easy task and would require parameters of quality/quantity if it is to be meaningful.

Q7. What is your view of our preference for a single appeals body?

a. Should, in the future, a single body hear all legal services appeals?

Yes. The discussion and conclusions in paras 229 to 245 are well set out and reasoned. Whilst a single unified body would be a large change to achieve prior to the implementation of the ABS regime, we believe that such an approach would be preferable provide that it can be achieved without delaying the introduction of the regime. In addition, a very important consideration is the speed and efficiency of the process of appeal to the single appellate body so that applications are not delayed.

b. If you do not think there should be a single body, who should hear appeals from LSB decisions, should it become a LA?

See answer to question 7(a) above.

c. Is the FTT, GRC an appropriate body to hear appeals?

It seems an obvious choice for a single appeal body.

d. What other options for the location of the body?

We cannot think of any.

Q8. Do you agree with our approach to special bodies?

a. Do you think that special bodies' transitional arrangements should come to an end?

We do agree with your approach to special bodies but find it hard to follow precisely what you are proposing in relation to transitional arrangements. We think that it is consistent with our understanding to answer 'no' to this question.

b. Do you think 12 months after the start of mainstream ABS is sufficient time for them to gain a full licence?

We are not convinced that special bodies should automatically become ABS so it seems inappropriate to suggest a 12 months timescale or to set any particular timescale. We believe that after priority licensing attention is given to the first wave of ABS applicants it would then be appropriate for LAs to consider applications from special bodies in whatever timescale then seems appropriate.

c. Do you think LAs should adapt their regulation for each special body?

Special bodies should not assume special pleading status but should be considered by LAs as ABS applicants in the same way as any other applicant.

d. Do you agree there are some core requirements that all special bodies should meet? If so, what do you think these are?

It is hard to say what core requirements should be other than to urge LAs to apply as far as possible the same licensing criteria across all types of ABS applicants.

e. What are your views on the suggestion that the OLC should make voluntary arrangements with special bodies?

A uniform complaints process against all types of ABS is to be desired. We would prefer to see special bodies made subject to the same regime, if possible on a compulsory basis as a condition of a licence.

Q9. Do you think that our approach to HOLP and HOFA is suitable?

a. Do you think that our approach on focussing our compliance systems across the organisation is suitable?

Yes. We agree that your approach to HOLP and HOFA issues in paras 269 and 280 is correct.

b. Do you think that HOLP and HOFA should undergo a fit and proper test?

Yes. We agree with para 274.

c. Should there be training requirements for the HOLP and HOFA?

Training or not (because not all HOLPs or HOFAs may need it) there should certainly be some assessed assurance of skills and competence and/ or a common threshold to ensure that all HOLPs and HOFAs meet the necessary minimum standards of knowledge and ability.

d. Do you agree that the HOLP and HOFA could be the same individual (especially in small ABS)?

Yes.

Q10. Do you think that our approach to complaints handing is suitable?

a. Do you think that ABS complaints should be handled in the same way as non ABS complaints?

Yes.

b. Do you think that ABS should be allowed to adapt their complaints handling systems if they already have one for their non legal service consumers?

We favour as much uniformity of approach as possible avoiding different complaints handling for different types of legal service. The current distinction between 'service complaints' handled by the LCS and misconduct handled by the SRA often involves blurring at the edges. In the arena of ABS regulation of reserved and unreserved legal activity the OLC and the ARs will need to establish a clear and understandable (to consumers and practitioners, legal or non legal) regime for handling

complaints of different kinds. Potentially the ABS regime could make this more complicated but care must be taken to ensure that it does not do so.

c. Do you think it is appropriate for the OLC to take complaints from multi disciplinary practice consumers and refer where necessary?

Yes.

Q11. What are your views on our proposed course of action to conduct research and depending on their result, either compel transparency of data or encourage it?

a. Do you agree with our position on diversity and ABS?

In general we support the analysis, distinction and proposals in paras 308 to 320 but we are not in favour of compulsion of data publication at this stage. That is different from supplying diversity data to the LA at renewal/review of licence stage (if that happens). The BSN annual survey is an increasingly informative source of diversity data based on the volunteer participating firms willing to have their data published. This participation should be encouraged but not compelled.

b. Do you agree that the overall impact is unlikely to be adverse to the diversity of the profession?

Hopefully, yes, if impact means impact of the research (this question is rather unclear).

c. Do you agree that non-lawyer managers may open new career paths to lawyers and these may have a positive impact on career progression?

Yes.

d. Do you agree that the demand for diverse legal professionals will, largely, offset the potential impact due to the closure of small firms?

Yes.

e. Should the LSB require information about the diversity of the workforce in ABS? If so, when and should this be a requirement for other legal services providers?

Yes. See our answer to Q11(a) above. This information should be collected from ABS and non ABS.

Q12. Do you agree with our approach to international issues?

As a firm that conducts cross border legal services in Scotland and Spain with an outsourcing office in Sri Lanka, we fully support the strong LSB approach to international issues in relation to ABS. It is essential that the international dimension is tackled by the LSB and LAs in a manner that enhances global opportunities for UK based ABSs rather than being confronted by barriers erected by legal professions in other jurisdictions due to protectionist motives.

Q13. Should LDPs, Recognised Bodies and other similar firms have transitional arrangements into the wider ABS framework in the way we propose?

a. Is 12 months after the start of mainstream ABS sufficient time to allow this to happen?

Yes.

Q14. Should ABS licences be issued for indefinite periods?

a. Should the annual charging process be broadly cost reflective or a fixed fee?

We favour cost reflective. We also favour an indefinite period for a licence subject to the safeguards in the LSA and para 348. But we anticipate that the annual renewal/review by way of entity based regulation by the LA will also amount to a monitoring process.

b. How should LAs ensure ABS are continuing to comply with their licence requirements?

We suggest that the entity based return currently completed for the firm at the time of practising certificate renewals by individual solicitors could be adapted to fit this purpose for an ABS.

Q15. Do you agree with our approach to regulatory overlaps?

a. Is it desirable to have a framework approach to a MOU?

Yes.

b. Do you think we have identified the right bodies to develop a MOU with?

Yes.

c. Do you think we have identified the right issues to include?

Yes.

Irwin Mitchell
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