Legal Services Board consultation:

"Regulation of special bodies/non-commercial bodies"

Response from the Solicitors Regulation Authority

July 2012

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Introduction

1. The Solicitors Regulation Authority (SRA) is the independent regulator of solicitors, the firms in which they practise and all those working with them. The SRA is also a licensing authority for alternative business structures (ABS). Of particular relevance to this issue is the fact that the SRA regulates both solicitors, as individuals, and entities delivering legal services to the public. Primarily these entities are firms of solicitors but, since the advent of the Legal Services Act 2007 (LSA) and the SRA's designation as a licensing authority under that Act, they may also be ABS, potentially with no solicitors as owners or managers. The SRA regulates in the public interest.

2. The SRA welcomes this opportunity to comment on the LSB's consultation on the licensing regime for special bodies/non-commercial bodies. The implementation of the provisions of the LSA regarding these entities is the most significant part of the Act yet to be implemented. This response commences with a review of key issues raised in the paper (Section 1), and then sets out responses to the questions posed in Annex C of the consultation paper (Section 2).

SECTION 1

Key issues

3. "Improving access to justice" is one of the LSA s.1 regulatory objectives to which the SRA must have regard when discharging its responsibilities. There is no generally agreed description of the meaning of the term. However, within the context of the Act and the SRA's regulatory responsibilities, it clearly requires that the SRA must have regard to the need for those who require legal services to have access to them in ways that make that access real, rather than theoretical. The SRA recognises that important parts of the pattern of legal services provision in England and Wales are made up of a range of entities that fall outside of the traditional solicitors' firm model. Particularly since the 1970s this has included a range of not for profit agencies, charities, advice centres and law centres.

4. Before the implementation of the LSA, the regulation of these entities, to the extent that they employed solicitors providing solicitor-like services to the public, presented challenges to the SRA and, before it, the Law Society. This was because the statutory framework within which regulation took place, limited the SRA's powers effectively constraining the models through which solicitors could work, and the entities through which they could provide services to the public, to those wholly owned and controlled by solicitors. The

range of advice agencies which developed did not fit within the structures which could be regulated.

5. For this reason, the regulatory position of these entities has always been somewhat unsatisfactory. The solicitors within them have continued to be regulated by the SRA and, in regulatory terms, continued to be treated as "employed" solicitors. The regulatory regime for employed (or in-house) solicitors was largely founded on the concept that they solely provided services, including the undertaking of reserved activities, to their employer. Over a period of time, from the 1970s onwards, the regulatory arrangements were amended to permit solicitors employed by advice agencies to provide services to the public (i.e. to people other than their employer) as an exception to the general regulatory rule that employed solicitors could only provide services to (and on behalf of) their employer.

6. This regulatory approach has been a progressively less satisfactory one. Importantly it has been so because the two regulatory approaches for employed solicitors and for regulated entities have been different. This has particularly been the case since the SRA has increasingly focused on the regulation of the entities through which solicitors deliver services rather than on the regulation of individuals. For example, many of the regulatory requirements that provide important protections for clients, and consumers generally, are applied to regulated entities and those who own and manage them. Even though many (but not all) of these provisions are brought back in to apply to employed solicitors when undertaking work for third parties other then their employers, the regulatory provisions are as a result unnecessarily complicated. Similarly, the approach has been insufficiently flexible for advice agencies to develop their provision of legal services in ways that they would wish.

7. For these reasons the LSA provides a significant, and long awaited, opportunity to resolve and remove many of the difficulties flowing from the old framework. It will enable the regulation of entities (other than firms owned and managed by solicitors) in a manner that is able to recognise the realities of their structures, the services they provide and the clients to whom they deliver legal services. It will enable a set of risk-based regulatory arrangements consistent with the regulatory objectives and, importantly, the principles of better regulation; arrangements that are transparent, proportionate and targeted.

8. The consultation refers both to "special bodies" and to "special bodies/non-commercial bodies". It is not always clear whether a particular approach is intended for all the bodies covered in s.106 LSA or only for some. For the sake of brevity, this response refers to "special/non-commercial bodies". However, the comments primarily relate to those bodies in the non-for-profit advice sector, as this is the sector to have received extended treatment in the consultation. It is recognised that all of the s.106 bodies - not-for-profit organisations, trade unions, community interest companies, "low risk" bodies, and other bodies brought within the framework by way of a specific order – raise different issues and will require separate consideration under the new licensing framework.

9. The SRA agrees with the LSB view that changes to the regulatory framework should be risk-based. Given this, further development of the LSB's assessment of the comparative risks associated with each type of body to be covered by the framework will be helpful. This analysis will, in any event, need to be undertaken by the SRA in order to inform its approach and it will be helpful to this development if there is an open dialogue involving the SRA, LSB and the agencies affected by these changes (including their representative organisations).

10. The consultation devotes relatively little space to community interest companies (CICs). These are still a relatively novel form of business organisation. As limited companies that can make a profit and pay limited dividends – albeit subject to "asset locks" which prevent the assets, including most of the profits, being used other than to advance their social purpose - they appear to be driven by an unusual hybrid of not-for-profit and more recognisably commercial considerations, and will require careful consideration in the design of the new framework. It will be necessary to ascertain the numbers currently providing legal advice and/or employing solicitors. The SRA will work with the statutory Regulator of CICs and stakeholders generally to build up an appropriate risk profile.

11. The other substantive issue on which the SRA believes further work will be required is the legal question of when a reserved service is being provided to "the public or a section of the public" under s.15(4) LSA (which engages the need for an organisation to be licensed).

12. Section 15(9) LSA makes provision for the Lord Chancellor to make an order, on the recommendation of the LSB, stating what does or does not constitute a section of the public for the purpose of s.15(4). As the SRA develops the new framework for special/non-commercial bodies and works with stakeholders to build a clearer risk profile of their activities and customers, the SRA's view is that it may be desirable to seek such an Order with a view to ensuring a consistent framework across the sector. The public interest, consumer protection and the creation of a more effective regulatory framework will govern the SRA's thinking in this respect. The SRA would seek to work closely with the LSB as this issue develops.

13. As set out above, there is at present a close relationship between the regulation of employed solicitors and the regulation of special/non-commercial bodies. For this reason the SRA intends to co-ordinate its work on the special/non-commercial bodies' framework and its review of the provisions for in-house practice generally. (For the sake of clarity, it should be noted that, once a body has become regulated under the new framework, its solicitors will cease to be treated as "in-house" under the SRA regulatory arrangements, because they will then be employed by a regulated entity in the same way as a solicitor in a law firm or ABS.)

14. Section 106(1)(e) LSA provides that a body of a kind not otherwise specified in that section can become a special body by way of an order of the Lord Chancellor made on the recommendation of the LSB. It will be helpful for the LSB to give as early an indication as possible should it be considering recommending any such Order.

Scope of regulation

15. As the consultation paper explains, the LSA only requires bodies providing reserved legal activities to the public or a section of the public to be licensed. In the November 2011 response to the LSB's consultation "*Enhancing consumer protection, reducing regulatory restrictions*" , the SRA argued that, in the public interest, the provision of *all* legal services should in future be brought within a proportionate statutory scheme of regulation. (See http://www.sra.org.uk/sra/consultations/consultation-responses/enhancing-consumer-protection-reducing-regulatory-restrictions.page)

16. In the SRA's view this would ensure that appropriate public protections would be available to all consumers of legal services and provide clarity and consistency for consumers whenever they accessed a legal service. It would bring these benefits to customers of non-commercial organisations which provided only non-reserved services to the public. In keeping with this broader policy on the regulation of legal services, the SRA strongly supports the LSB's proposals to extend the current list of reserved areas of work to encompass the legal activities of will-writing and estate administration. (See http://www.sra.org.uk/sra/consultations/consultation-responses.page)

A consumer-centred approach to the regulation of special/non-commercial bodies

17. The SRA agrees that the new licensing regime should be outcomes-focused, risk-based, proportionate and effective. It should be targeted at achieving the right outcomes for clients and securing the broader public interest, while avoiding inappropriate or disproportionate regulatory burdens. This is the approach the SRA takes to law firms and ABS, and it is particularly appropriate for special/non-commercial bodies given the specific statutory provisions contained in the LSA.

18. The regulatory framework for these bodies must be developed in accordance with the s.1 Regulatory Objectives and other provisions in the LSA that place requirements on Approved Regulators. The SRA agrees with the statement in the Impact Assessment that "the mitigation of risks to the consumer and the potential impact on access to justice" will be issues that must be considered carefully in the regulation of special/non-commercial bodies.

19. The starting point for the SRA's approach is that consumers should receive an equivalent standard of protection whether they receive services from a conventional law firm, an ABS authorised under the general licensing scheme, or an ABS licensed as a special/non-commercial body. Those seeking services from special/non-commercial bodies are entitled (as are all other clients) to receive appropriate outcomes, and the SRA's current approach to the authorisation, supervision and enforcement of regulated individuals and organisations provides the regulatory mechanisms to ensure that this happens. The particular characteristics of clients of these bodies (often described as carrying particular vulnerabilities) are not, of themselves, a rationale for setting reduced levels of protection or less rigorous outcomes. The key issue will be to identify the risks to the achievement of the regulatory objectives that are applicable to organisations of these types (they will almost certainly differ to those present in recognised bodies and other licensed bodies) and ensure that the regulatory arrangements in place address those

risks adequately and proportionately. Therefore, whilst the same outcomes for clients are sought, the regulatory arrangements necessary to achieve them will almost certainly be different to those necessary for other types of organisations with different risks.

20. The key will be to identify, on a risk basis, where it will be appropriate to modify the SRA's general regulatory requirements because of objective differences. Where there would be an increased risk of consumer detriment, through standards of protection being reduced, the SRA believes that it should be for the body to make a case for appropriate modifications. To aid this process one option will be to identify a range of appropriate and proportionate variations to the general regulatory arrangements to assist prospective special/non-commercial bodies in identifying amendments which might be appropriate to their organization and circumstances. These could be designed around the broad categories of body covered under s.106, with each option including a range of in-built modifications taking account of the different risks to consumers posed by different types of body.

21. Further modifications could be applied for where the organisation could demonstrate that a particular requirement was unnecessary in the public interest or that an equivalent standard of consumer protection could be achieved by another route. The various membership criteria, governance structures and consumer protections associated with different types of body might be taken into account in this regard.

22. It is possible that both the applicant bodies and licensing authorities may not be able to be as bespoke in the approach to individual licensing decisions as the consultation envisages. It would be desirable, in the interests of transparency and cost, to avoid a system which was impractical, overly resource-intensive or disproportionately costly, both to regulators and to applicants. The approach outlined at paragraphs 21 and 22 above could provide a more streamlined and cost-effective authorisation process.

23. Prospective special/non-commercial bodies would be able to identify the possible approaches most suitable for them and apply for authorisation accordingly. In this respect it is important to remember that the authorisation process will not simply consist of considering the extent to which modifications to the general regulatory approach should be made. This will be but a part of bringing entities that have not previously been regulated into regulation as licensed bodies. Therefore, the process that will have to be followed will be a licence application and authorisation process plus the consideration of modifications to the underlying regulatory arrangements.

Content of licensing rules

24. The SRA is in the process of reviewing its current regulatory arrangements to identify what would be an appropriate and proportionate framework for special/non-commercial bodies. This review will ensure that any changes to the framework are focused on outcomes and the risks to the achievement of those outcomes.

25 The initial view is that certain key requirements of the Handbook are likely to strike the right balance between protecting consumers and providing flexibility

for special/non-commercial bodies without, at this stage, strong evidence indicating a likely need for significant modification.

26. For example, the application of the SRA Accounts Rules is already limited to bodies and individuals holding or receiving client money, and it is not apparent that there is likely to be an overriding consumer interest for applying a different standard to client money held by special/non-commercial bodies. The fact that the money of , usually, clients of moderate means might be at stake appears to reinforce the need to retain the high level of protection already available to clients of a licensed or recognised body. However, it is possible that such bodies *may* be able to identify different mechanisms to ensure the same, or an equivalent, level of protection. Should this be the case, the SRA would consider the substantive approaches put forward.

27. Similarly, it follows from this consumer-oriented perspective that where client money is held, special bodies/non-commercial bodies should be subject to the compensation arrangements that provide assurance for clients should that money be lost through fraud or a failure to account, and be required to have a Compliance Officer for Finance and Administration (or an appropriate individual performing an equivalent role).

28. The SRA has commented further on the possible content of licensing rules in its response to question 10 in Annex C to the consultation paper – see section 2 below.

Activity-based regulation

29. The SRA recognises that a greater emphasis, in the longer term, on a more activity-based approach to regulation is likely to be consistent with its stated policy for the regulation of all legal services. However, the discussion in the consultation paper could, in the SRA's view, be clearer in how it treats the non-reserved areas of employment and welfare benefits advice. A approach to licensing which makes it more difficult for consumers to understand the nature of the regulatory protections that applied when legal services were being received would not be in the public interest. The position under the LSA 2007 is, in any event, not wholly straightforward. The Act is clear that, in order to provide reserved legal activities to the public or a section of the public, an entity must be authorised to do so (i.e. be either a recognised or a licensed body). Consistent with this, it flows from the Act that if an entity is providing only unreserved legal activities it does not require authorisation as a licensed body under the Act (although the LSA provisions do not reduce the SRA's responsibilities and powers to regulate individual solicitors under the Solicitors Act 1974). However, the position (under the LSA) of unreserved legal activities being delivered by a body that is licensed (because it delivers reserved legal activities) is not straightforward. Importantly, it is not, in the SRA's view, the case that in such circumstances, a licensed body's unreserved legal activities can be considered as outside of the scope of the regulation required by the LSA. Therefore, this is an issue that requires further analysis and consideration.

Removal of unnecessary regulatory restrictions

30. As a risk-based, outcomes-focused regulator, the SRA is clear that that regulatory intervention must be targeted, appropriate and proportionate through the use of the full range of regulatory tools open to it. In implementing a risk-based outcomes-focused approach to the regulation of individuals and authorised bodies, it has already largely addressed the need to remove over-detailed requirements which cannot be justified on the basis of the legislation under which it operates (not solely the LSA 2007) and the Better Regulation Principles. However, it is accepted that it is possible that not all unnecessary requirements have been addressed in this exercise, and the regulatory arrangements need to be kept under constant review as the external environment within which they apply changes and the risks they are designed to address change.

31. The consultation paper identifies two aspects of the SRA's regulatory arrangements, which were approved by the LSB in 2011, which the LSB believes should be amended prior to the introduction of the licensing of special/non-commercial bodies: the outcomes preventing mainstream legal activities from being "hived-off" into a separate, unregulated business (Chapter 12 of the SRA Handbook), and the provisions particularly affecting solicitors employed in the advice sector dealing with charging professional fees (rule 4 of the SRA Practice Framework Rules).

(a) Business structures

32. The consultation raises the possibility that special/non-commercial bodies will want to expand their services and provide these through "separate trading arms", which might be prevented by the current regulatory arrangements applying to "separate businesses". However, whilst it might be expected that, in an environment of a reduction of income from public-funding these organisations might be exploring a range of options, it is not wholly clear from the consultation paper the kind of activities and structures envisaged. Given this, it is difficult, on the basis of the level of detail provided in the paper to judge this or to see clearly that it bears the weight of the LSB's conclusion on this important issue, or satisfactorily addresses the risks to consumers. In any event, given that these organisations are not regulated as entities, it is an issue that is of limited practical impact prior to the ending of the current grace period under the LSA.

33. The SRA is aware of the complexities involved in balancing the sometimes competing objectives of protecting the interests of consumers, promoting access to justice, and promoting competition through permitting the widest appropriate range of business structures for the delivery of services to consumers. These complexities are added to by the unsatisfactory basis for the regulation of legal services provided by the "reserved activities" approach. The SRA has made clear to the LSB that it is committed to keeping its current provisions on separate businesses under review both through learning from the experience of regulating recognised and licensed bodies and through active engagement with all stakeholders. However, the SRA's view is that the route to reform that would best serve the public interest would be a proper review of the scope of legal services regulation. As long as this is based on the very narrow foundations provided by the reserved activities, other

approaches, such as the separate business rule, are, in the SRA's view, likely to remain in the public interest and in the interests of consumers.

34. The SRA's starting point remains that where a body is authorised to provide reserved legal activities, all of its "mainstream" legal activities should be provided through that regulated entity. This ensures that:

- clients have the benefit of the protections that go with instructing a regulated business, e.g. the Compensation Fund and professional indemnity insurance;

- consumers are not confused about who is providing the services, and whether and by whom those services are regulated. A significant level of confusion exists amongst consumers about the extent to which legal services are regulated. This consideration may be of greater relevance in respect of the vulnerable consumers who are more likely to obtain their services through special/non-commercial bodies, and for whom the problem of information asymmetry may be particularly acute; and

- in practical terms, entities and the services they provide are capable of efficient proportionate regulation – the boundaries between legal activities and non-legal activities are, generally, clear (but not without some complexity) whereas the boundaries between reserved legal activities and non-reserved legal activities are far more blurred and regulating at this boundary would not only give rise to a lack of clarity for consumers but would significantly increase the difficulties of effective regulation.

35. For example, a law centre might propose to divide its reserved and non-reserved activities between a licensed body and an unregulated body respectively, and continue to employ solicitors to deliver the non-reserved services through the latter. An arrangement of this kind might both deprive consumers of the statutory protections accompanying entity regulation, and significantly increase the scope for consumer confusion. The SRA would have to be confident that both issues could be satisfactorily overcome with no significant loss of consumer protection before making a general change to its regulatory arrangements to permit a model of this kind.

36. The consultation suggests that if the SRA identifies risks to consumers from particular business structures it can identify on a case-by-case basis what a proportionate regulatory requirement should be, rather than special/non-commercial bodies making the case for a waiver. The SRA remains of the view that, on balance, the public interest in preventing regulatory avoidance and consumer confusion outweighs the risks of limiting the range of business structures. Special/non-commercial bodies will still be able to apply for modifications/waivers of the licensing rules in their particular circumstances.

37. In future, the SRA believes that a proportionate "whole market" approach to regulation will bring all legal activities within the ambit of an appropriate regulatory regime. This would be the preferred solution to the risks to consumers which current provisions are designed to mitigate. It is noted that a similar point was made by the Consumer Panel in its response to the LSB's

recent consultation on the scope of legal services regulation (http://www.legalservicesboard.org.uk/what_we_do/consultations/closed/pdf/enhancing_consumer_protection/LSCP.pdf.)

(b) Restrictions on charging fees for advice.

38. The second provision in the SRA's rules which the LSB argues should be removed is that particularly affecting solicitors employed in the advice sector dealing with charging professional fees for their advice. Special/non-commercial bodies which become fully regulated entities under the new framework (licensed under Part 5 LSA 2007) will be able to charge the public for legal activities in the same manner as any other authorised entity. Given this, the issue raised in the consultation paper is a timing issue in respect of those entities which will become licensed, and a permanent issue in respect of solicitors employed in the advice sector who undertake non-reserved services only, and whose employers therefore do not need to be licensed. Subject to the review of the regulation of employed solicitors, these solicitors will continue to be regulated as individuals under the provisions of the SRA Practice Framework Rules for in-house practice.

39. The SRA understands the funding difficulties faced by many bodies in the not-for-profit advice sector. It would not be in the public interest for the network of free advice services to wither away. It is understandable that charging should be considered as an option in terms of enabling the bodies concerned to continue operating.

40. There are a number of background factors that provide context to this issue.

41. First, the current provisions, contained in Rule 4.16 of the Practice Framework Rules 2011, were largely unchanged at the point of the introduction of OFR through the implementation of the Handbook in October 2011. Partially this was because it was known that significant changes to the regulatory approach for many of the entities covered by this provision were imminent, with the ending of the grace period for special/non-commercial bodies (at that time expected to be April 2013). Whilst a number of the provisions are clearly relevant to the new regulatory approach under the LSA 2007 (e.g. Rule 4.16 (e) requiring indemnity cover), there are others which clearly require further examination, (e.g. it is not clear that the protection of the title "law centre" through the SRA's regulatory arrangements is addressing a risk to the achievement of the regulatory objectives).

42. Second, as has been set out above, at the point at which special/non-commercial bodies are licensed, the SRA sees no objective regulatory rationale why they should not be able to charge for the services they provide in the same manner that recognised and other licensed bodies charge for services. At that point (if not addressed before) the SRA will necessarily need to consider the position of special/non-commercial bodies that do not become licensed (because they provide solicitor legal services to the public but not reserved activities) in regard to their ability to charge. This will need to be done in the context of both the licensing regime for special bodies and the outcome of the review into the regulation of in-house practice.

43. Third, in this response, the SRA has set out the different bases for the regulation of the provision of legal activities to the public through recognised and licensed bodies (entity and individual based) and through special/non-commercial bodies (where there is no entity based regulation and regulatory controls apply only to the individual solicitors in the entities). These different bases give rise to different risks. For example, in a special/non-commercial body under the current arrangements, the SRA has no regulatory grip over the entity or over the managers of the entity. Given this, it is, in principle, understandable if the regulatory requirements for recognised/licensed bodies and for solicitors in special/non-commercial bodies differ, in order to proportionately address those different risks.

44. Given this context, and specifically in relation to charging for services, the key questions to be considered are:

- given the current statutory framework, LSA regulatory objectives and the principles of better regulation, what risks to the regulatory objectives is the regulatory intervention (i.e. of preventing charging for services) designed to address;

- is it an effective, targeted and proportionate means of addressing any such risks; and

- if the answers to either of those questions suggest that the intervention is unnecessary or not effective, targeted and proportionate, and should be removed or replaced, should or can action be taken before the ending of the current grace period?

45. Relevant to this consideration is also the question of whether the current regulatory approach, including the restriction on charging for services, is itself creating additional risks against any of the regulatory objectives. In its consultation paper, the LSB draws particular attention to concerns that, in the face of funding cuts, the current restriction runs the risk of having a negative impact on the "improving access to justice" regulatory objective. In considering this, the SRA necessarily needs to consider the current provision in the context of all of the regulatory objectives. For example, it has been argued that allowing solicitors employed by unregulated bodies to charge professional fees for services without the body itself having to bear the cost of entity regulation might introduce distortions in the operation of the market. Whether or not this might be the case (and given the relative level of regulatory fees it might be questionable) would require analysis.

46. In addition, for example, it has been argued that the ability to charge individual consumers for services within organisations that have not hitherto charged in this way might introduce new risks. For example, whether the introduction of charging would alter the culture and incentives at work in organisations which have not charged up to now, and if so, what might the impact be on risks to the consumer? Again, this would require analysis although it also has to be recognised that many of these organisations have for many years received payments directly related to individual clients through the legal aid system.

47. The SRA is not prejudging the outcome of any consideration of this issue, and it is clearly open to question whether the current restriction on charging is addressing an identifiable and current regulatory risk (rather than being a legacy of the initial arrangements put in place in the 1970s to enable law centres to operate). The SRA's planned approach had been to consider fully the question of solicitors employed in special/non-commercial bodies charging fees for work in the context of the projects to implement the special bodies licensing regime and in the review of in-house practice generally. However, we note the LSB's concerns and will, as a priority, discuss the issue further with it. In deciding the most appropriate way forward the issue of the timing of the ending of the grace period will be a relevant factor. The extent to which the application of resources (to undertake the analysis and then consult and seek approval from the LSB to any changes to the regulatory arrangements) whilst progressing the two major reviews is the best way forward (rather than maintaining the current provisions and managing the changed environment through the operation of the waiver provisions) will need to be considered.

48. In the interim, the SRA will proceed to consider applications for waivers of the existing charging provisions in the Practice Framework Rules. A number of organisations have approached the SRA with a view to such waivers being granted and these will be considered against the published waiver criteria, in the context of the changed external environment within which these organisations are operating, and also in the context of the issues raised in the LSB's consultation paper and addressed in this response.

Consumer protection issues

49. The absence of entity regulation has resulted in significant gaps in the data available to the SRA on special/non-commercial bodies, their solicitors and their customers. For example, complaints to the SRA about individual solicitors in not-for-profit advice services appear to be rare, but, for example, the SRA has no way of knowing how many are settled within the organisation concerned. The SRA will work with the LSB and other stakeholders to try to fill these information gaps in the period up to licensing.

50. The SRA broadly agrees with the analysis of consumer protection issues identified in the consultation, and with the LSB's conclusion that neither existing frameworks nor group licensing provide sufficiently targeted or comprehensive consumer protection. It is noted in this regard that money laundering, proceeds of crime and "secret profit" issues, although not common, are not unknown in the charity sector, and have required action by the Charities Commission.

51. The consultation identifies a number of specific risks to consumers. The SRA Handbook already has requirements which mitigate these risks, and which might in future be applied to special/non-commercial bodies.

- *Governance and funding*

  The SRA agrees that unstable funding and inadequate governance arrangements can lead to unsatisfactory outcomes for consumers. SRA Principle 9 requires licensed bodies and individual solicitors to run their

businesses or carry out their role in the business effectively and in accordance with proper governance and sound financial and risk management principles. In addition, the current rules for solicitors working in law and advice centres seek to mitigate the risk of conflict with funders by requiring that funders do not dominate the management committees of these bodies.

- *Sustainability and lack of alternative providers*

  The potential impact of closure through bankruptcy or administration is serious, and the SRA is aware of a number of high profile instances. The introduction of entity regulation may help in this regard by bringing the entities into a formal regulatory authorisation and supervision regime and, ultimately, giving licensing authorities powers of intervention, etc which they currently lack.

- *Quality*

  SRA Principle 4 requires solicitors (and regulated entities and all those employed within them) to act in the best interests of each client; and Principle 5 sets down a requirement for those the SRA regulates to provide a proper standard of service to their clients. Chapter 7 of the Code of Conduct contains requirements concerning the management of businesses. For example, Outcome 7.6 requires firms to train individuals working in the firm to maintain a level of competence appropriate to their work and their level of responsibility; and Outcome 7.8 requires firms to have a system for supervising clients' matters, to include the checking of the quality of work, by suitably competent and experienced people.

52. In addition, the SRA's approach allows the firms and individuals it regulates the flexibility to manage the risks which relate to each individual client. For example, Chapter 1 of the Code or Conduct contains the key requirements concerning client care. Some of these are particularly relevant to vulnerable clients. For example, Outcome 1.1 requires that clients are treated fairly.

Ending the transitional period

53. The SRA agrees that the immediate priority is the development of the new licensing framework. The benefits of entity regulation and the statutory protections which come with this should be extended to clients of special/non-commercial bodies as soon as (but not before) a proportionate, flexible, risk-based and effective regulatory framework can be introduced. This will address the unsatisfactory current arrangements where legal activities are being provided to the public in a framework that is hampered by the absence of entity regulation.

54. The SRA supports the proposal not to end the transitional period before April 2014. It must be noted that entities will need to undertake a process of applying for licences and orders and these will need to be considered by the SRA before licences can be granted. This means that the arrangements for licensing will need to be settled, published and applications for licences being submitted by the middle of 2013. We will work within this period to collect

data, develop and consult fully on policy, design and test new processes, set fees, and issue orders and licences.

55. The new framework will have to be capable of ensuring that all affected bodies are licensed on the first day after the transitional period has ended for them to comply with the requirements of the LSA 2007. This means that the SRA may have to licence around 350 entities (many of which may be seeking bespoke variations to regulatory arrangements) in the run up to that date. This will present distinct operational challenges and will place much greater pressure on applicants and on the application process than was experienced with the introduction of licensing generally. It is important that there is sufficient time in the process for entities to understand the licensing requirements and prepare applications for authorisation and for the SRA to work with them to provide sufficient information on the process.

56. The SRA will work with the LSB and stakeholders to achieve the proposed new date. It is in the public interest that the SRA has the ability to regulate these organisations as entities and, indeed, this is the best way forward to address a range of the issues identified by the LSB; including that of charging for services. The current estimate of the work and resources involved suggests that achieving this date will be challenging. It is important that the sector has certainty around a date that all are confident can be delivered and, therefore, it would be helpful for there to be further detailed discussions involving the LSB, the sector and the SRA before the final decisions on the end date are set to ensure it is underpinned by robust planning assumptions.

Review of regulatory provisions on in-house practice generally

57. Bodies that will in future have to be licensed will become fully regulated entities, and the solicitors employed in those organisations will at that point no longer be treated as "in-house" under the SRA's regulatory arrangements. However, there will still be many organisations employing solicitors which will want to provide (or continue to provide) non-reserved activities to the public in accordance with the relevant provisions of the SRA Practice Framework Rules.

58. The SRA intends to develop the special/non-commercial bodies framework in parallel with a wider review of the regulation of in-house practice. In undertaking this work, the SRA will, in the public interest, consider carefully the most appropriate regulatory approach in accordance with the statutory remit and obligations under which it operates.

Trade unions and "low risk" bodies

59. The SRA broadly agrees with the approach proposed to "low risk" bodies, as these bear most of the salient characteristics of an ABS authorised under the general ABS framework and are likely to pose a similar risk.

60. The SRA agrees that in practice many trade unions may not want to expand beyond the membership activities they can already provide without the need to be licensed. However, it will be necessary to improve the information available about how many wish in future to provide reserved services to the public.

Next steps

61. During the course of the coming months the SRA will:

- Continue to develop its approach to the regulation of special/non-commercial bodies, including working with stakeholders to identify more clearly the risks to the achievement of the regulatory objectives;
- produce a high level stakeholder discussion document outlining the SRA's proposed approach; and
- develop a preliminary set of draft rules for consultation.

62. The SRA looks forward to working with the LSB and stakeholders during the development of the new framework.

63. Answers to the question posed in Annex C to the consultation are set out below.

SECTION 2

SRA response to questions in Annex C to the consultation paper

1) To what extent do you think the current non-LSA regulatory frameworks provide fully adequate protection for consumers?

SRA response:

The SRA agrees that the existing frameworks are inadequate, for the reasons set out in the paper. Neither the statutory requirements for particular types of body (e.g. charities) nor membership schemes are specifically targeted at the risks faced by consumers receiving legal advice. The SRA supports the introduction of entity regulation for special/non-commercial bodies as this will ensure consumers benefit from the full range of statutory protections available under the LSA. It will also provide clarity for consumers whose vulnerability may be greater than the broader population of legal services consumers because of their particular needs or circumstances.

The LSA is premised on the need for organisations providing reserved activities to the public to be licensed in the public interest. The SRA wants to see "whole market" regulation embracing all legal advice and services and regards the introduction of proportionate regulation to special/non-commercial bodies as an important advance in public protection (see http://www.sra.org.uk/sra/consultations/consultation-responses/enhancing-consumer-protection-reducing-regulatory-restrictions.page for our response to the LSB's consultation "*Enhancing consumer protection, reducing regulatory restrictions*".)**2) Do you agree with the LSB's assessment of the gaps in the current frameworks?**

SRA response:

The SRA broadly agrees. In particular, the SRA agrees that quasi-regulatory membership frameworks and those applying, for example, to charities, do not collectively provide a sufficiently comprehensive or targeted approach for the regulation of legal work by the bodies concerned.

The SRA strongly supports the introduction of entity regulation for special/non-commercial bodies, in the interests of consumers and the wider public interest.

3) What are the key risks to consumers seeking advice from non-commercial advice providers?

SRA response:

The SRA broadly agrees with those identified in the consultation paper. The SRA's comments are set out at paragraph 49 onwards above.

4) What are your views on the proposed timetable for ending the transitional protection?

SRA response:

The original proposal to end the transitional protection period in April 2013 has become untenable. The SRA therefore welcomes the suggestion that it should end at April 2014.

The need for most special/non-commercial bodies to be licensed from day one after the transitional protection period has ended requires that there is confidence that both entities and regulators will have sufficient time to undertake the application and approval process.

The SRA is committed to working with the LSB and stakeholders to bring in the new licensing regime within the new timeframe. However, it will be important to keep the implementation date under review throughout the development and implementation of the new arrangements.

5) Should we delay the decision of whether to end the transitional protection for special bodies/non-commercial bodies until we have reached a view on the regulation of general legal advice?

SRA response:

No, the public interest in ending the grace period provided by the LSA 2007 and moving these organisations into a system of entity regulation is such that this process should proceed at the earliest point consistent with a proper development and implementation process. The SRA would, however, urge the LSB to progress its work on the regulation of general legal advice as speedily as possible. Each strand of work should be developed with an awareness and a good understanding of what is happening in the other.

6) Do you have any comments on the Impact Assessment? In particular do you have any information about the likely costs and benefits of the changes set out in this document and/or information about the diversity

of the workforce or consumers that use special bodies/non-commercial organisations?

SRA response:

At present the SRA only regulates individual solicitors in those bodies which in future may become licensed as special/non-commercial bodies. This means that the SRA holds relatively little data about the organisations themselves as they are not regulated entities. The SRA intends to begin to gather further information in the course of working with stakeholders on this issue.

The SRA has a number of general comments to make on the IA.

- The IA says that account has been taken of the "risks to consumers of not ending the [period of transitional] protection" but does not appear to develop the point (page 1). Similarly, there is a reference to some bodies wanting to charge for their services (page 5), but no clear analysis of the possible impact on the full range of the LSA 2007 s.1 regulatory objectives were such a change to be made in isolation (given the context of the current regulatory framework and arrangements which apply to these bodies).

- The IA correctly addresses the benefits to consumers of bringing special/non-commercial bodies under entity regulation. The SRA fully supports the extension of entity regulation. However, further evidence-based analysis of the clients of these bodies and the nature of the risks they face, will be needed to ensure the development of a proportionate licensing regime. The SRA hopes the full IA will provide further assistance with this, and the SRA will work with the LSB and stakeholders to try to fill the gaps in the data.

- The IA does not appear to assign sufficient weight to the fact research generally shows that many consumers assume all legal services are regulated – and, therefore, that a benefit of aligning the way special/non-commercial bodies are regulated will be greater clarity for consumers.

At this point the SRA has no comments to make on the likely cost to special/non-commercial bodies of applying for a licence (page 6 of the IA). Further work will be required on the development of the regulatory approach.

7) What are your views on allowing special bodies/non-commercial organisations to charge for advice? What do you think are the key risks that regulators should take into account if these bodies can charge?

SRA response:

We anticipate that special/non-commercial bodies which become fully regulated entities under the new framework will be able to charge. See paragraphs 38 onwards above for the SRA's response to this question.

8) What are your views on our proposed approach to allowing a full range of business structures?

SRA response:

The SRA's view remains that it is in the interests of consumers to retain the separate business provisions until such time as all legal services are subject to proportionate regulation.

9) Do you agree with our analysis of group licensing?

SRA response:

The SRA agrees. Group licensing is not the way forward. It is not sufficiently targeted at the risks faced by consumers of legal services and does not deliver the benefits of the statutory protections attached to entity regulation of a legal practice.

10) What are your views on these issues that may require changes to licensing rules?

SRA response:

The SRA agrees that the areas identified will have to be examined carefully. Our initial views are as follows:

Insurance arrangements

The SRA's position is that the clients of special/non-commercial bodies are entitled to the protections provided by a requirement for compulsory professional indemnity insurance in the same way as clients of recognised bodies and other forms of licensed body. This will help fulfil the objective that "consumers should not be afforded significantly less protection because of the type of organisation providing the advice". In the case of the "low risk" category of body the SRA can see no reason why such a body should not have to maintain a policy of qualifying insurance.

In the case of the "not for profit" category of body, the SRA would again start from the position of requiring a policy of qualifying insurance, but would consider granting an order under section 106 in the event that the special body could demonstrate that it had in place professional indemnity cover reasonably equivalent to the cover afforded under the Minimum Terms and Conditions of cover set out in Appendix 1 to the SRA Indemnity Insurance Rules. The SRA believes that the market will be able to reflect the actual risk posed by a particular special/non-commercial body in the premium assessment so although the cover required for two special/non-commercial bodies may be the same, the premium may be significantly different depending on the nature and scale of the legal activities undertaken. This is the same for law firms in general.

The SRA Indemnity Insurance Rules and the SRA Handbook Glossary will need to be amended to cater for special/non-commercial bodies, in particular the "successor practice" provisions will need to be reviewed to ensure there

are no gaps in cover when a firm or ABS is succeeded by a special/non-commercial body which otherwise would qualify for reduced professional indemnity insurance.

Compensation arrangements

The SRA believes that clients of special/non-commercial body should be protected by appropriate compensation arrangements. Such clients are entitled to the same protection as the clients of any other regulated practice. At present, contributions to the existing Compensation Fund are required from solicitors and regulated entities holding client money. The SRA is currently undertaking a fundamental review of its compensation arrangements and it will ensure that work on this review is co-ordinated with the development of the regulatory approach for special/non-commercial bodies.

Accounts rules

The SRA Accounts Rules are intentionally prescriptive and detailed, and the SRA can, at present, see no justification for departing from this approach in the context of the regulation of special/non-commercial bodies (see paragraphs 29 to 33 of the consultation).

The rules exist to protect client money, and the same protection must be afforded to that money, regardless of amount held, the type of body/individual holding that money or the type of legal work the person/body conducts. If client money is held, the rules will apply. If no client money is held, the rules will not apply (see end of paragraph 42 of the consultation).

There are no waivers of the rules, except for Part 6 (Accountants' Reports), so a special/non-commercial body that holds client money would have to comply with the rules but may be granted a dispensation from the obligation to deliver an accountant's report in appropriate circumstances.

A special/non-commercial body which does not hold client money will not be required to operate a client account (paragraph 49 of the consultation).

Conflict of interests

The Outcomes in the SRA Handbook regarding conflict will apply both to the special/non-commercial body itself and to the individuals working within it, just as they do with any regulated practice. The SRA will consider the most appropriate way of addressing the issue of conflicts concerning members of the governing body and with funders.

Appeals

The SRA has concerns with the proposals in respect of appeals, and in particular the suggestion that the appellate body for appeals that affect special/non-commercial bodies should be the First Tier Tribunal of the General Regulatory Chamber.

The SRA is concerned about whether a blanket distinction between special/non-commercial bodies and all other bodies can safely be made. For example:

- some bodies such as large trade unions or large "low risk" firms will be of significant means, whereas some other law firms (which may well be committed to pro bono work and public or charitable purposes) will be of very low means; and

- "low risk bodies" are no different in practice from other ABSs save for the level of non-authorised interest in the firm.

The SRA also remains of the view that the payment of costs for failed appeals should be borne by the person who brought the appeal. The alternative is that the cost of potentially unmeritorious appeals is passed on to all other regulated persons and ultimately the consumer. The SRA does not agree that this is appropriate. The Solicitors Disciplinary Tribunal (SDT) does have a discretion to make such order as it thinks fit in each case. The concerns raised above about the difficulty in treating all special/non-commercial bodies in a particular way is also relevant in this respect.

Finally, if there are concerns about costs orders in respect of special/non-commercial bodies, appointing and training a new appellate body for some SRA decisions appears to be an inappropriate and disproportionate way to resolve these concerns. SDT members already have expertise in respect of the SRA's regulatory regime and are well placed to consider ABS appeals. It appears to be more appropriate and proportionate to analyse what changes if any are needed to the existing arrangements rather than create a new set of appellate arrangements. Maintaining the same appellate body for all ABS appeals would also improve consistency of decision making. The SRA feels that this is particularly important taking into account that there will be little practical distinction between some special bodies and other ABSs - low risk bodies in particular.

Schedule 13

The SRA broadly agrees with the high level views expressed by the LSB in respect of Schedule 13 of the LSA. However, greater clarity about the LSB's proposals would be welcome. The additions to, amendments and revocation of the provisions of Schedule 13 for each special/non-commercial body will be a very important part of the consideration of an application. This is a complicated area which the SRA feels would benefit from more analysis prior to the adoption of a policy by the LSB in this respect. For example:

- the LSB consultation indicates that all special/non commercial bodies will be subject to some of the provisions of Schedule 13 or similar provisions but does not address the extent to which s.105 LSA disapplies Schedule 13 to independent trade unions;

- does the LSB consider that there will be some situations in which all of the provisions of Schedule 13 should be disapplied?

- contrary to the indication in the consultation paper, Schedule 13 is in the SRA's view capable of being applied to most if not all special/non-commercial bodies. The references to the exercise of 'voting power' (paragraph 3(1)(e) of Schedule 13) in particular appear to necessitate a broad application of the material interest test .

Requirement for HOLP/HOFA

The SRA sees no obvious reason for not requiring a person in the role of HOLP/COLP in any organisation providing reserved services to the public, and particularly in a special/non-commercial body where governance and conflict issues can arise in relation to funding, and where staff may well be volunteers. The SRA's strong view is that all special/non-commercial bodies will require a HOLP.

Again, the SRA's view is that if client money is held, then the protections envisaged by the appointment of a HOFA/COFA should apply in the case of special bodies and the client money it holds.

Training requirements

The training requirements in the SRA Handbook apply only to individual solicitors and trainees.

The outcomes in Chapter 7 of the Handbook (management of your business) require staff in a regulated practice to be trained to a level of competence appropriate to their work and level of responsibility, and to be properly supervised.

The SRA believes that these provisions are unlikely to require/justify amendment.

Consistency with the LSA requirements for employers and employees

It is not entirely clear what this paragraph is aimed at. Rule 4 of the SRA Practice Framework Rules, which deals with in-house practice, will not apply to solicitors employed by organisations which are licensed as special/non-commercial bodies. It will continue to apply only to solicitors employed by organisations which are not regulated entities. These solicitors will continue to be regulated as individuals.

The design of the framework for special/non-commercial bodies and the solicitors working within them (who will no longer be "in-house") will be governed by the need to be proportionate, flexible, outcomes-focused, risk-based and effective.

The SRA has begun work on the general review of in-house provisions.

11) Are there any other areas where the LSB should give guidance to licensing authorities?

The consultation devotes little space to trade unions, "low risk" bodies and community interest companies. It will be helpful to have a more detailed

discussion of the LSB's assessment of the comparative risks associated with each type of special body, and of the wider interpretation of s. 15 LSA.

Solicitors Regulation Authority

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