

ALTERNATIVE BUSINESS STRUCTURES: APPROACHES TO LICENSING

Response of the Faculty Office on behalf of the Master of the Faculties to Consultation paper on draft guidance to licensing authorities on the content of licensing rules published by the Legal Services Board on 10 December 2010

Introduction

1. Whilst the Faculty Office is seriously concerned about the financial and manpower implications of responding to a plethora of consultation papers (especially papers running to 111 pages), it is nevertheless grateful for the opportunity to respond.
2. The LSB has already received the Faculty Office's response of 12 August 2009 to its discussion paper "Wider Access, Better Value, Strong Protection". We remain seriously concerned about the practicability, and likelihood of acceptance abroad which is the focus of almost all notarial activity, of ABS in relation to notarial activities (see p.83, paragraph 332), and are unaware of any interest so far expressed by any person for ABS in relation to these, including by what is referred to as "investors" (p.1). We note the acceptance that it may be "unlikely that notaries will choose to work in an ABS" (p.83 paragraph 333). Who in respect of notarial activities is seeking the "freedom to empower their businesses"? (p.1). In this context, we welcome the recognition under the heading "International Issues" (p.8) that "other jurisdictions may have the power to limit particular models from operating in their jurisdiction", which is likely to be the case in respect of notarial activities, especially within Europe.
3. In relation to notarial activities, we question whether "innovation and entrepreneurship" (p.1) will achieve "good outcomes" (p.1) and whether they should be ends in themselves, save in so far as they contribute to meeting the "regulatory objectives" in s.1(1) of the LSA 2007 (which of course include protecting consumers and promoting competition in the provision of services). Whether the use of terms such as "market" (p.1) is justifiable in respect of other reserved legal activities lies outside the competence of the Faculty Office.
4. The Faculty Office cannot at present envisage circumstances in which it would seek to be approved as a licensing authority ("LA").
5. The Faculty Office is insistent that all the costs arising from the operation of LAs and ABS be ring-fenced so that the ABS pays for them. The rest of the profession cannot be expected to pay for the cost of regulating ABS of which they are not a part.
6. We are further concerned in relation to the complexity of what is now proposed but lack the resources to devise and recommend a simpler approach. This is unfortunate given the implied intention in the consultation paper (p.3) that over time the new framework of core outcomes will guide the approach of ARs regulating non-ABS. The stated aim (p.4) is to "promote better, more targeted and more proportionate regulation".

Along with some other ARs, the Faculty Office urges the LSB to bear that phrase, and in particular the reference to proportionality, in mind in anything it introduces.

7. On the other hand, the Faculty Office agrees – as it could not fail to do - with the LSB’s starting position that customers of an ABS “should be no less protected than those in other parts of the market”

Question 1 - What is your view of basing the regulation of ABS on outcomes?

Broadly agreed.

a. Should all LAs have the same core outcomes?

Yes. We agree that there should be no opportunity for “weaker” ABS regimes in some cases (p.17). But we question whether it is right that rules should only be made “where there is only one appropriate way to ensure consumer protection and broader public interest” (p.11), given the consensus in responses to the discussion paper that there should be a “tough licensing regime” for ABS (p.16). Horrid though the terminology is, we agree that the outcomes should be “consumer focussed” (p.17).

b. Are the proposed outcomes appropriate?

Broadly yes

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

Yes, but this unveils the inherent problem with the concept of ABS, and will be particularly acute in the unlikely event that ABS embrace notarial activities. Also the distinction between “entity” and “individual” regulation begins to break down when one sees that that the operation of a business is conducted by individual persons. We do not want the new emphasis on entities to throw a corporate veil over ABS under which individuals can hide behind after the operation goes wrong, especially when Parliament has spent 30 years trying to find ways of making directors of companies more accountable for their decisions. Money laundering legislation demonstrates the difficulty in separating out the “management” and “conduct” parts of a business. Under the Proceeds of Crime Act 2002 the individual might be liable for not disclosing a money laundering activity, but may nevertheless have a defence if not given proper training by his manager. The regulatory role of the LA must not impair the AR’s powers over the individual.

Question 2 - Do you think our approach set out to the tests for external ownership is appropriate?

Broadly agreed.

a. Should the tests be consistent across all LAs?

Yes.

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

Yes, with two qualifications. First, we would have thought that “management competence” was a highly relevant matter for an LA to consider as part of their licensing process (p.26). Second, we welcome the breadth of the description “any other material information that might have a bearing on their fitness to own the ABS” (p.89), whilst recognizing its imprecision and hence arguable legal uncertainty.

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

Indubitably yes. This is very important. Spent convictions may still be relevant for the purpose of assessing the probity of the individual.

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

We favour a strict approach, with only a very limited *de minimis* exception.

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

Yes.

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

We lack competence to respond.

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

Ditto.

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

Probably not.

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

Yes.

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

The LSB should be prepared to use its own disqualification powers.

Question 3 - Do you have views on how indemnity and compensation may work for ABS?

For the most part, no.

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?

We lack competence to respond.

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

Yes.

c. Are Master policy arrangements appropriate for ABS?

We lack competence to respond.

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

We lack competence to respond.

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

We lack competence to respond. Whilst there are attractions in the alternative considered in the second sentence of paragraph 151 (p.40), we cannot see any justification for requiring “non-ABS firms” to put money on trust to cover fraud claims against ABS. All ABS costs must be ring-fenced.

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?

We lack competence to respond.

Question 4 - Do you agree with our position on reserved and non-reserved legal activities?

Yes.

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

Yes, of course.

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

Yes.

c. What role do you see consumer education playing?

We do not doubt the importance of “consumer education”, but are not qualified to express a view on whether this should be done through requirements placed by LAs on ABS.

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

We favour the approach in the first sentence of paragraph 168 (p.43), and do not share the concern expressed in the final sentence about disincentives.

Question 5 - Are the enforcement powers for LAs suitable?

Yes.

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

On balance the proposal for an unlimited penalty (p.51) is agreed.

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

N/A

c. Will LAs have sufficient enforcement powers?

Possibly not. However, the proposal (p.52) that irrecoverable ABS costs may be “recovered from the licensed community as a whole” is only acceptable if confined to the community of ABS.

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

Presumably so.

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

The Faculty Office sees no reason to differ from the analysis in paragraph 203 (p.52).

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

We lack competence to respond.

Question 6 - What do you think of our approach to access to justice?

Broadly agreed.

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

With some regret, yes.

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

With some regret, no.

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. There maybe risks in the singular approach, but singular impact should not be wholly irrelevant. The risk to existing notarial practices of ASB competition could be devastating, without any commensurate gain to the public.

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

Yes, in so far as they are able without excessive cost.

Question 7 -What is your view of our preference for a single appeals body?

Not agreed. However we are not clear what sort of appeals such an appeals body would be hearing. The terms of review must be carefully defined. While we understand that there should be a consistency of approach between LAs in the regulation of ABS we do not want the new body to displace the authority of the Approved Regulator. This is

especially the case because s.52(4) of the Act provides that where there is a conflict between a requirement of the regulatory arrangements of the entity regulator and the requirement of the regulator of an individual, the requirement of the entity regulator shall take priority. If a single body is created to which aggrieved ABS may apply to and which has large powers of review, both the LAs' and the ARs' regulatory role could be undermined to an extent not anticipated by Parliament. If the ARs and LAs are not discharging their regulatory and licensing responsibilities correctly it should be up to the LSB on application to the Lord Chancellor to take action according to the machinery provided by the Act.

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

No. This would inevitably mean extra costs passed on to the public/consumer, and would be precisely the sort of interference/regulatory perfectionism which is disproportionate. A single body to hear all ABS related appeals would be much preferred. Whichever option is chosen only LAs should be expected to contribute to the cost of the new appeals body (or bodies) out of ABS licensing funds.

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

The question is misleading: see the final sentence to a. above.

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

Probably not but we lack competence to respond with confidence.

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

We see no problems in a new single body to hear all ABS related appeals and sitting in London.

Question 8 - Do you agree with our approach to special bodies?

Broadly agreed.

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

Probably yes, though it is unclear whether there is a requirement in the public interest for additional measures.

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

We lack competence to respond, but think it likely that 24 months would be more appropriate for bodies lacking administrative resources.

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

Probably yes, in accordance with paragraph 263 (p.67).

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

Yes, but we lack competence to specify the core requirements.

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

This seems a sensible proposal.

Question 9 - Do you think that our approach to HoLP and HoFA is suitable?

Broadly agreed.

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

Probably yes, but we claim no particular competence here.

b. Do you think that HoLP and HoFA should undergo a fit and proper test?

Yes.

c. Should there be training requirements for the HoLP and HoFA?

Yes.

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

Probably yes.

Question 10 - Do you think that our approach to complaints handling is suitable?

Broadly agreed.

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

Probably 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 services consumers?

Probably yes.

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

Probably yes.

Question 11 - What are your views on our proposed course of action to conduct research and, depending on the results, either compel transparency of data or encourage it?

Broadly agreed, though concerned as to cost implications.

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

Yes.

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

We lack competence to respond, but we suspect that diversity may be adversely affected.

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?

We lack competence to respond, but doubt that there will be “a positive impact on career progression”.

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

We doubt there will be this off-setting, and are seriously concerned about the impact on existing small firms.

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 service providers?

With some reluctance, we consider this is likely to be desirable for all legal service providers.

Question 12 - Do you agree with our approach to international issues?

The Faculty Office re-iterates the views referred to in paragraph 332 (p.332), and is pleased at the acceptance that the matter will be kept “under review” (paragraph 333). It is considered that the regulation of a very few notaries working in ABSs is likely to present serious problems, whoever is the LA.

Question 13 - Should LDPs, Recognised Bodies and other similar firms have transitional arrangements into the wider ABS framework in the way we propose?

Broadly agreed.

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

Some form of transitional arrangements is needed. We doubt 12 months is sufficient.

Question 14 - Should ABS licences be issued for indefinite periods?

Reluctantly, probably yes.

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

Probably they should be “cost-reflective”, but the matter is not of concern to the Faculty Office so long as there is no financial impact on notaries who do not practise in ABS.

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

The potential size and disparity of interests within ABS will make difficult the task of LAs in ensuring compliance with licence requirements, and the maintenance of standards more generally. This is a problem to which we have no complete answer. It is, however, important that the inherent difficulty in regulating ABS does not mean that the standards are *de facto* lower than in the case of the generally high standards in non-ABS

Question 15 - Do you agree with our approach to managing regulatory overlaps?

No.

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

Desirable as a MoU may appear, we suspect this is another unnecessary layer of bureaucracy, with adverse financial consequences for existing ARs. Would it not be better to wait and see whether there are serious “regulatory overlaps” which need to be eliminated?

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

We lack competence to respond.

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

Ditto. See a. above.

Post-script

The Faculty Office, whilst admiring the diligence within the LSB in preparing this Consultation Paper is seriously concerned that it should be expected to answer no fewer than 76 separate questions. It considers that there must be a more cost-effective way of conducting consultation and introducing a new regime consistent with the statutory regulatory objectives and Better Regulation Principles, and the overarching principle of proportionality.