Solicitors Regulation Authority

SRA response

Ministry of Justice's consultation on 'Legal services: removing barriers to competition'

Published on 01 August 2016

Read more about the Ministry of Justice's consultation on 'Legal services: removing barriers to competition' [https://consult.justice.gov.uk/digital-communications/legal-services-removing-barriers-to-competition/supporting_documents/legalservicesremovingbarrierstocompetition.pdf]

We welcome the opportunity to respond to the Ministry of Justice's (MoJ) consultation on Legal Services: removing barriers to competition.

The Solicitors Regulation Authority (SRA) is the regulator of solicitors and law firms in England and Wales, protecting consumers and supporting the rule of law and the administration of justice. The SRA does this by overseeing all education and training requirements necessary to practise as a solicitor, licensing individuals and firms, setting the standards of the profession and regulating and enforcing compliance in accordance with these standards.

The SRA's regulated community is diverse. It includes alternative business structures (ABSs) with lawyer and non-lawyer managers/owners and multi-disciplinary practices made up of lawyers and other types of service provider. Around 15 percent of barristers are employed in SRA-regulated businesses, as are many conveyancers, intellectual property lawyers, notaries, legal executives and costs lawyers.

Competition drives choice for consumers. The legal services market is evolving faster now than at any other time in its history. Providers are changing how they organise themselves and their services; changing consumer behaviour both drives and responds to these supply-side developments. An open, competitive market is essential if we are to ensure consumers can access the legal services they need.

Findings from our 'Innovation in legal services'[1] [#n1] research suggest that legal professionals are becoming more innovative in the organisation and management of their business. Significantly, ABSs are 13–15 percent more likely to introduce new legal services than other types of regulated firms. Fears regarding the ethical standards of ABSs have not come to pass.

A market that is welcoming of innovation is attractive to investors and potential new entrants, and encourages existing businesses to differentiate and to compete. The potential benefits in terms of domestic value and international investment are now even more valuable against the backdrop of Brexit.

We are currently undertaking a comprehensive review of our regulatory framework, which includes a two-stage review of the SRA Handbook. Our aim is to ensure that we develop a flexible and future-proof set of regulatory arrangements that are clear, transparent and promote and support compliance. Greater flexibility will also provide benefits to those firms looking to innovate, compete and grow.

Our overarching aim is to make sure that we have a system of regulation that delivers against a set of core professional principles and clear standards, and which enables good, committed, lawyers and their firms to meet the diverse legal needs of an increasing number of consumers and the public. Professional standards, and effective enforcement against those standards, are fundamental to public protection. Those standards have to be set by the regulator and must reflect the expectations of the public.

We therefore welcome the MoJ's proposals to provide flexibility and remove unnecessary restrictions for ABS businesses wanting to enter the legal services market. To date, we have authorised approximately 450 ABSs. In early 2016, were viewed our data relating to these firms to understand (from a regulatory perspective):

- Whether ABSs can be distinguished from non-ABSs (traditional) firms by any particular characteristics.
- What types of services ABS firms provide, whether they have targeted specific areas of law, and whether there is evidence of the level of service they provide.
- Whether there is any evidence that ABS firms pose a different level or kind of risk compared to traditional law firms in respect of consumer protection, the rule of law and the proper administration of justice.

In considering the outcomes and decisions that arose from SRA investigations into reported issues, there is no evidence at this time that ABS firms present any elevated level of risk. Reports concerning ABS firms are slightly less likely (6 percent) to be assessed as serious compared with matters reported against all firms (ABSs and non-ABSs).

In light of our experience, it is our view that Schedule 13's current levels of prescription (and Schedule 11 as to what our licensing rules must cover) are unnecessary. Further, there is a significant risk that the current level of prescription and detail set out in primary legislation:

- may lead to overregulation in some areas and under-regulation in others
- reduces flexibility for regulators to amend their approach in light of market changes and/or based on their experience
- introduces different statutory provisions for ABSs compared with traditional law firms without justification
- creates barriers, blockages and inconvenience for new entrants that have proved to be unnecessary.

Our full response to the consultation questions is below.

Consultation on proposals to make amendments to the Legal Services Act 2007

1. Do you agree with the proposal that there should not be a requirement to provide services consisting of, or including, reserved legal activities from a practising address as currently required by paragraph 15 of Schedule 11?

We agree with the proposal to remove the requirement in paragraph 15 of Section 11 of the Legal Services Act for ABSs to have a practising address in England and Wales and to provide reserved legal activities from that address, and with the rationale for removal provided in the consultation. We agree that a consistent approach should be taken and that there is no reason why there should be statutory restrictions for ABSs when they do not exist for other types of legal services firms. Rule 15.4 of our Practice Framework Rules requires all authorised bodies to have at least one practising address in England and Wales. We would like to be able to apply the same flexibility to ABSs that we currently extend to recognised bodies, where we are able to waive the requirement for them to have a practising address in England and Wales where there is good reason to do so. In reviewing our Handbook we are considering this requirement to ensure it does not unnecessarily restrict, for example, the development of either online or cross-border services.

2. Do you agree with the proposal that:

a. the requirement for an ABS to have a practising address in England and Wales is retained in paragraph 15 of Schedule 11 but Licensing Authorities may waive this requirement or may make licensing rules enabling them to waive this requirement; or
b. alternatively, paragraph 15 is replaced with a power enabling Licensing Authorities to make licensing rules about addresses?

Our preference is for option b – to replace paragraph 15 with a power enabling Licensing Authorities to make licensing rules about practising addresses. This option would afford regulators the greatest flexibility to adapt and adopt a range of approaches, depending on developments or emerging models in the market, and would ensure consistency across all types of legal services providers.

3. Do you agree with the proposals to amend Schedule 13 to the 2007 Act and allow Licensing Authorities to make their own rules around ownership of an ABS and to impose a statutory obligation on the LSB to provide guidance regarding ownership?

We strongly support the proposal to amend Schedule 13 to the 2007 Act and allow Licensing Authorities to make their own rules around ownership of an ABS, and when and how approvals are obtained. As noted in previous discussions with the MoJ – and also discussed in the consultation paper – the current drafting of Schedule 13 causes problems in its application, and does not provide sufficient flexibility for us to deal with less than straightforward business structures. The complicating factor usually revolves around the associates rules, and how those apply in the case of:

- group structures
- private equity structures
- unincorporated owners
- minors.

Our regulatory experience over the past five years suggests that the anticipated risks concerning non-lawyer ownership of firms that were instrumental in the development of Schedule 13 have not been realised. While it might be argued this proves the detailed controls in Schedule 13 have been effective, our view is that Schedule 13 is not appropriately targeting those we need to assess.

In summary, Schedule 13 causes problems in its application, particularly in relation to less than straightforward business structures. The criteria capture people who are actually very unlikely to have a significant interest because, for example, they are far up the corporate chain, or – in many cases – fall

within the 'associates' provisions. Conversely, structuring the business in certain ways can circumvent the criteria entirely. On a practical level our checks are stringent enough to understand who presents a risk, but the test does not always align. This is because the test both makes us approve those who are not a risk and because it sometimes does not capture those who are. In simple terms, the test does not work as it should.

In our view, the legislation should be amended to impose a requirement for regulators to ensure that all non-authorised individuals with significant influence or control over the provision of legal services are fit and proper persons to provide those services. The precise way in which that is done should be left to regulators' discretion, with legislation focused on the outcome they are trying to achieve. It is through consistency of outcome that the regulatory objectives and better regulation principles can best be achieved, rather than through prescriptive legislation mandating a common approach.

We consider that it is for the regulators to make rules as to the threshold at which approval is required, with a power to take into account associates, parent undertakings and voting powers. This would allow greater flexibility for us to adapt to the risks posed in particular circumstances.

We do not think that it is necessary or proportionate to impose an additional statutory requirement on the LSB to provide guidance. The LSB already has a duty to provide guidance under section 162 of the Legal Services Act, and has done so in relation to licensing rules [2 [#n2]]. We consider that the scope of that duty is sufficiently broad to include the provision of guidance regarding ownership, if necessary.

The additional check and balance of the LSB rule approval process should be sufficient to ensure a consistent and coherent approach across the regulators.

4. Do you think amending Schedule 13 and giving Licensing Authorities greater discretion in deciding on the necessary checks for licensing, would encourage more applications from businesses to become ABS?

Although it is not possible to quantify in terms of absolute or estimated numbers, we think it is likely that amending Schedule 13 would have a positive effect on the number of businesses applying to become ABSs. Our own experience is that it is very difficult for some categories of firms to become licensed as an ABS. For example, the current arrangements are not attractive to those with plcs in the structure, particularly in cases where there are nominee companies that hold shares in bulk on behalf of investors. Private equity (PE) structures also find the sheer volume of approvals they need to obtain a barrier to licensing – a recent PE structure required over 20 owner approvals for all the limited partnerships, where, in reality, the only real control sat at the very top with the LLP and its three members.

5. Do you think giving Licensing Authorities greater discretion would reduce the timescales and cost of the licensing process, and if so, by how much?

We have already made significant changes to speed up our authorisation process (with much success) within the existing arrangements, but we continue to be restricted by the degree of prescription and inflexibility in the current legislation.

Under the proposed new arrangements, we would have discretion to align our procedural arrangements to properly identify and address risk, and to only require approval of those individuals who have a significant control or influence over a business. We would, therefore, be able to shift focus to those areas that present a level of risk to consumers or the public, and to better target our regulatory resources to those areas that present risk.

While for some firms this may increase the number of approval applications we are required to handle, for many this has the potential to reduce the time taken and cost of the licensing process.

6. Do you agree with the proposal to repeal section 83(5)(b) of the 2007 Act?

We agree with the proposal to repeal section 83(5)(b) of the 2007 Act, which seems both sensible and proportionate. The Act obliges all approved regulators to consider the impacts of each of the regulatory objectives in the Legal Services Act, and to act in the way most likely to meet them. Access to justice is just one of those regulatory objectives.

In our experience, applicant firms struggle to complete this section of their application, and it adds little value, with most firms relying on a general statement that the addition of their legal services business to the market will meet the objective of increasing access to justice.

7. Do you agree that Licensing Authorities and ABS applicants would make savings in terms of costs, time and resources, if we were to repeal section 85(5)(b)?

In our experience, applicants struggle to provide this information, although it is difficult to quantify the amount of time and resource they may have put in to trying to do so. However, we consider that

removing the need for them to consider this issue is likely to save time and resources. Removing this requirement would therefore seem to be both sensible and proportionate.

8. Do you agree with the proposal to amend sections 91(1)(b) and 92(2) of the 2007 Act?

We agree with the proposal to amend sections 91(1)(b) and 92(2) of the 2007 Act. We have already removed the requirement for recognised bodies, as we considered the requirement to be unnecessarily onerous, and not to address any identified risk. In our experience, compliance officers will monitor and assess the full range of non-material breaches in the course of their daily business, and as part of their normal compliance arrangements.

For consistency, we also consider that the MoJ should amend the requirements at 91(3) (b) and 91 (4) (b), which require that the Head of Legal Practice of a licensed body must:

- as soon as reasonably practicable report to the licensing authority failure by the licensed body, or any of its employees or managers who are authorised persons, to fail to comply with duties imposed by section 176 and specified in licensing rules, and
- as soon as reasonably practicable, report to the licensing authority any failure by a non-authorised person to comply with the duty imposed by section 90 in relation to the licensed body.

9. Do you agree with the proposal that regulators should provide guidance to businesses on how they define 'material' failure to comply with licensing rules?

We do not consider that there is a need for a statutory duty for regulators to provide guidance to businesses on how they define a material failure to comply with licensing rules.

The consultation notes that the SRA provides guidance to firms on material breaches. This is correct. However, our guidance is in the form of case studies, rather than prescriptive guidelines, and is designed to assist firms in making a judgment as to materiality. Any breach may be material in its own right, or a pattern or recurrence of minor breaches may cumulatively lead a compliance officer to report a material breach. The decision to report is ultimately one for the compliance officer to make on a case-by-case basis. Our guidance is intended to support compliance officers in making those assessments.

We are currently undertaking a comprehensive review of our regulatory arrangements, including the SRA Handbook, and our enforcement strategy. As part of that programme of work we are also developing a support package for individuals and firms. This will include online toolkits, decision trees and a range of case studies that set out issues we consider to be serious and reportable, and where we may take enforcement action.

We have a concern that, in making guidance in any particular area statutory, the guidance becomes (or is seen to become) prescriptive and mandatory – and this can lead to confusion about its status, particularly in relation to other published guidance or toolkits. This is something that we have experienced with our current Handbook, and is one of the drivers for moving to a high-level, flexible, and future-proof framework supported by a range of resources.

In our current consultation, Looking to the Future [https://higher-rights.sra.org.uk/sra/consultations/consultation-listing/code-conduct-consultation/] , we have noted that we are happy to work with firms who are seeking to develop bespoke guidance or toolkits, and would be equally happy to work with other regulators on the same basis. In our view it is often the case that working with others on their guidance can prove extremely effective. We are keen, therefore, to retain as much flexibility and control over the way we approach guidance.

10. Do you agree that regulators and ABS businesses would make savings in terms of costs, time and resources if we were to amend sections 91(1)(b) and 92(2) of the 2007 Act, and if so by how much?

We agree that regulators and ABS businesses would make savings in terms of costs, time and resources if the MoJ was to amend sections 91(1)(b) and 92(2) (and 91(3) (b) and 91 (4) (b)) of the 2007 Act. The majority of the savings are likely to be made by ABSs, who will be better placed to advise on the resource currently taken up by the existing requirement to record and report non-material breaches. We took an earlier decision to remove the requirement to report non-material breaches from recognised bodies; (and to provide further guidance on the recording of non-material breaches (during 2015)); in response to views from stakeholders that these posed an onerous requirement, with little evidence that they were addressing any identified risk.

11. Do you agree that the proposed changes to ABS regulation are sufficient to ensure a level playing field for entry to the market and regulation in the market for ABS and other firms? If not, what further changes do you think would be needed?

We agree that the proposed changes are sensible and proportionate measures, and are ones which will help to ensure a level playing field for entry into and regulation in the market for all types of firms. In

response to Question 12 to this consultation, we make two further suggestions for additional changes, and will be happy to discuss these further should that be helpful.

12. Are there any further amendments that might be made to a specific provision of, or schedule to, the 2007 Act which deals with the regulation of ABS? If so, please explain why and where possible provide evidence to support your argument.

'Taking a step'

While we appreciate that this requirement mirrors current financial services rules, it continues to pose a significant problem for firms and is certainly a cause for some large group entities not entering the market or, where they already are authorised, deciding not to float.

If an individual wants to buy a material interest in a plc parent of a licensed body, the need to apply for and obtain our approval before they can take any further steps is contrary to the free trade principles behind plcs. Prices fluctuate constantly and there is also the risk of the proposed acquisition leaking and affecting the prices before it can be secured. That is a serious legal issue as well as being detrimental for all involved.

While this may be partially addressed by changes to the material interest holder provisions (often those with ten percent plus in a plc parent will have minimal control or knowledge of a distant licensed body so may not meet a new definition of 'owner'), it will remain a problem where they do.

Some flexibility around timing would be helpful here. If we required firms (or their parents as appropriate) to be clear with investors that any acquisition in advance of approval would be subject to that approval (ie they need to be fit and proper), and the implications of acquiring in advance of that decision (potential divestiture), then there is likely to be minimal harm in them notifying us on acquisition rather than needing our approval before they can take a step.

Notification requirements

Paragraph 21 to Schedule 13 relates to notification requirements on proposed new investors in licensed bodies. This requires only that they must 'notify' us, but not how they notify. Notify is not defined anywhere in the LSA, so we have to take it on its dictionary meaning of:

Inform (someone) of something, typically in a formal or official manner.

For just about every other approval or authorisation we undertake, we have the power to specify the application requirements, which allows us to require applications are made on the 'prescribed form'. However, the 'notify' requirement for owners means we cannot make them apply in that fashion. If they choose to send us an email saying they intend to buy a material interest, we have to take that as day one of the decision period. It then makes it very difficult for us to get the necessary information to make an approval decision in the consequent 90 days, and we may have to object because of a lack of information. This has caused problems for us on a number of occasions.

It would therefore be helpful if the schedule gave us the power to set rules around how they need to notify us so we can make them subject to the prescribed form.

Notes

1. Innovation in legal services [https://higher-rights.sra.org.uk/sra/research-publications/innovation-report/] report
2. Alternative business structures: approaches to licensing (PDF 36 pages, 320K) [http://www.legalservicesboard.org.uk/what_we_do/consultations/closed/pdf/abs_guidance_on_licensing_rules_guidance.pdf] and Alternative business structures: appeals against decisions of licensing authorities (PDF 3 pages, 53K) [http://www.legalservicesboard.org.uk/what_we_do/consultations/closed/pdf/supplementary_guidance_on_licensing_rules.pdf]