ICAEW REPRESENTATION 118/16
REGULATORY REPRESENTATION

# Proposals to make amendments to the Legal Services Act 2007

ICAEW Professional Standards welcomes the opportunity to comment on the *Consultation on proposals to make amendments to the Legal Services Act 2007* published by the Ministry of Justice (MoJ) on 7 July 2016, a copy of which is available from this link.

ICAEW has both regulatory and membership functions which operate independently in a single unitary body. On occasions representations are asked from both the regulatory and membership arms and this is one of those occasions. This response dated 3 August 2016 is made by Professional Standards, the regulatory arm. A separate representation in addition to this one has been made by the membership arm through their Business Law Committee.

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ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 145,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

ICAEW was granted status as an Approved Regulator and Licensing Authority for the reserved legal service of probate in August 2014, and since that time has both authorised accountancy and other firms and licensed them as Alternative Business Structures (ABSs) for probate services, currently regulating over 200 firms and over 300 Authorised Individuals in this activity.

In addition ICAEW as a regulatory body is;

(a) the largest Recognised Supervisory Body (RSB) and Recognised Qualifying Body (RQB) for statutory audit in the UK, registering approximately 3,200 firms and 8,400 responsible individuals under the Companies Act 1989 and 2006.
(b) the largest Prescribed Accountancy Body (PAB) and Recognised Accountancy Body (RAB) for statutory audit in Ireland, registering approximately 3,200 firms and 7,500 responsible individuals under the Ireland Companies Act 2014
(c) the largest Recognised Supervisory Body (RSB) for local audit in the UK, registering 8 firms and 84 key audit partners under the Local Audit & Accountability Act 2014.
(d) the largest single insolvency regulator licensing some 750 insolvency practitioners as a Recognised Professional Body (RPB) under the Insolvency Act 1986 out of a total UK population of 1,700.
(e) a Designated Professional Body (DPB) under the Financial Services and Markets Act 2000 currently licensing approximately 2,300 firms to undertake exempt regulated activities under that Act.
(f) a Supervisory Body recognised by HM Treasury for the purposes of the Money Laundering Regulations 2007 dealing with approximately 13,000 member firms.
(g) an accredited body under the Financial Conduct Authority (FCA) Retail Distribution Review (RDR) arrangements.

In discharging these duties ICAEW are subject to oversight by the FRC's Conduct Committee, the Irish Auditing and Accounting Supervisory Authority (IAASA), the Insolvency Service, the Financial Conduct Authority and the Legal Services Board.

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## MAJOR POINTS

1. We welcome this review of parts of the Legal Services Act 2007 (the Act) and the steps the Ministry of Justice (MoJ) are taking to simplify aspects of the registration for Alternative Business Structures which we amongst many regulators considered excessive in their content. These were enacted in the Legal Services Act 2007 inter alia to ensure the integrity of those who aspired to carry out legal services in a mixed practice. However subsequent experiences in licensing and the established track record of the Legal Services Board (LSB) and the accredited licensing authorities have demonstrated that some of the perceived risks have been over-compensated for. A review of the legislation 9 years after enactment and 5 years after the first ABSs were licensed is a timely point to remove this excess layer of regulation.

2. We note in the introduction to the paper the government's vision for a strong competitive market where consumers and the public interest are protected. However we noted with some discomfort that the proposed changes made no reference to the outcomes intended by the original legislation, whether those outcomes themselves continued to be relevant, and if they could be achieved in another fashion. Rather the comparison was made between the different rules for authorised firms as against licensed firms and the need to align the rules for both types of entity. As a consequence we are not sure the regulatory outcomes have been fully considered and in particular whether the differences in some instances reflected a weakness in the regulation of authorised firms rather than excess regulation.

3. We note the profile of complaints for ABS compared with traditional law firms is stated at paragraph 22 as one of the reasons why the ABSs do not warrant special treatment, but we would caution that the licensing of firms which started in 2011 takes time for a practice to work through and have a significant impact on the market, and then for a breakdown to occur in the service warranting a complaint. This life cycle is still young and different trends could evolve over a longer period of time. We are also not convinced that the volume and substance of complaints provides a complete indicator of the achievement of all the outcomes sought under the legislation, particularly in matters of control which would not ordinarily be a matter of concern to the consumer but may at a political level be problematic.

4. ICAEW have contributed as a body with the other licensing authorities to the discussions with the MoJ regarding these changes, and for this reason we believe that the changes do not adversely impact the regulatory objectives. It may be helpful however in reviewing the results of the consultation that the original outcomes are given further thought to provide assurance in this area.

5. We note the general thrust to give greater discretion to the licensing authorities to apply the regulatory principles. This does provide the basis for a more proportionate risk based regime that is adaptable to the areas of expertise the licensing authorities and their licensed firms may be focused on. However from a public interest perspective there needs to be safeguards to ensure the outcomes are being achieved under this more flexible regime, and we believe the LSB as the oversight body has a greater role to play in ensuring that the approach of the licensing authorities under the wider discretion is balanced and focused and addresses the outcomes.

## RESPONSES TO SPECIFIC QUESTIONS

**Question 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?**

6. We agree that the current approach for ABS is inconsistent with that applied for authorised firms, and that the inhibition this places for example on the provision of internet services can make this a limitation to the development of the market.

7. However we believe that some further thought is required in this area before easing the restriction. There is a much wider issue around the provision of legal services both reserved and unreserved through the internet as the enforcement powers of the licensing authorities and the LSB are contained within UK and English and Welsh boundaries. The requirement for an operating address in England and Wales does enable some sort of interaction within the jurisdiction and enable oversight of the service provision to be better monitored and regulated. A further consideration is the need to have an identifiable address whether in the jurisdiction or outside at which documents may be served in negligence proceedings brought by a consumer.

8. If the Act is to facilitate overseas supply of reserved legal services through the internet without a UK base, then consideration is required to alternative mechanisms to deal with quality assurance, complaint handling and enforcement. This is perhaps a wider issue than these immediate measures can deal with, but we would suggest that some further thought is required before the rules are relaxed as proposed so that the safeguards for the consumer are not compromised.

**Question 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?**

9. As pointed out in the preceding paragraphs, a concern remains around enforcement. It may be appropriate to relax the requirement for the reserved activity or any legal service to be provided in England and Wales as long as there was still an operating address in the UK. However we think the state has a responsibility to be clear on the protocols and rules in this area and should not leave the matter to licensing authorities where they may simply not be able to regulate effectively.

10. The development of artificial intelligence as well as cross-border internet supply is going to become an increasing issue, and patching up historic arrangements may not be enough to preserve the outcomes sought in this area.

11. We would therefore suggest that (a) is applied provided the outcomes and principles are clearly defined and the process overseen by the LSB.

**Question 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?**

12. The outcomes sought by the existing rules is not explored in the consultation document but are understood to be around inappropriate ownership that could undermine some of the statutory objectives. We agree that the current approach is far too complex, and we would refer to the rules around audit firm ownership, which whilst requiring set elements of control, are flexible in assessments of fit and proper individuals, acknowledging limitations in for example overseas data protection and commercial laws. This is a discretion given to Recognised Supervisory Bodies for audit and the proposals here are similar in nature.

13. A more discretionary regime with a principles based approach would therefore be better. The current requirements are too lengthy, detailed and prescriptive. This results in disproportionate costs for providers and regulators. It also denies the regulator the flexibility to appropriately target regulation at identified risks in accordance with better regulation principles. It can also make processing applications lengthy and difficult. For example, it can often be difficult identifying those that fall within the definition of “material interest” including spouses and children, employers and other businesses in which they are directors; and the requirement to

carry out DBS checks on all non-authorised owners can be unnecessarily time consuming and costly and disproportionate to the risk.

14. We endorse the role of the LSB in setting the framework, and would also expect them as part of their oversight duties to be reviewing the arrangements that the licensing authorities put in place under those guidelines.

**Question 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?**

15. In the long term this will be the case, but in the immediate term as the licensing authorities work through the changes in their own rules, they are likely to be cautious in how they might approach this initially. Also shared experiences between firms on their applications to licensing authorities will be based on the old rules, so even though the regime might be less demanding that may not be readily understood by firms that might otherwise consider applying until sufficient awareness is created in the market.

16. Ironically any new organisation that wishes to become a licensing authority may be the most effective at opening up the market, as their rules will be set at the minimum standard to start with. However their lack of experience in what constitutes areas of risk may pose risk to the quality and reputation of ABSs as a whole, and some additional safeguards may be necessary for example through clear outcomes and supervision being set by the LSB when approving any such future body.

**Question 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?**

17. We believe there will be a reduction in the time scales, but the extent of this will depend on the guidance issued by the LSB and the risk mitigation steps that would replace the detailed requirements. In practice the mechanical part of this within the licensing authorities may be in the margins, but significant time would be saved through not having to consult external agencies such as the Disclosure Barring Scheme on such a wide scale. The speed with which these agencies respond is not regulated by statute so the timescale within which a licensing authority approves applications is highly dependent on these external agencies.

18. Linked in with the reduced requirement for fit and proper investigations would be the reduction in costs associated with securing such information and the administration and etiquette of the responses. We estimate up to 5 man days may be saved in process time and perhaps £5,000 in costs could be eliminated on a complex application for a medium sized professional practice as a result of more focused and proportionate rules. By the same token it could be possible to reduce the turnaround in applications by over 2 weeks if the external agencies are as agile in their future processing.

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

19. The requirement for a firm to set out how it might improve access to justice as a result of receiving a license has always seemed to us to be a paradoxical requirement in legislation intended to open up the market. The ability to influence this area by an individual firm is questionable and it is not really appropriate for such general policy objectives to be set at such a low level. The irony is that simply by applying as an ABS there is an automatic opening of market choices and a self-fulfilled prophecy.

20. We also support the observation that the requirements placed on the Licensing Authorities to fulfil the statutory objectives would automatically achieve the outcome sought by this measure making it superfluous anyway. Consequently we wholly endorse the removal of this obligation.

**Question 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 83(5)(b).**

21. We have found the approach of firms to this particular question quite varied. Some have been quite brief, and others have put together a detailed business case which clearly will have taken them some considerable time and effort. Such detail has to be reviewed by the case manager in case it impacts fit and proper assessments so the whole thing can be elongated unnecessarily for both applicant firm and licensing authority. In practice therefore, this adds cost and time for applicants to provide such information and for regulators to consider the information provided while generating no incremental value.

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

22. Yes we agree with the proposal to amend these sections. ABSs currently have to report any failure to comply with or breach of the rules. This level of prescription is unnecessary and adds to cost and time for ABSs to provide this information and for regulators to review it. It therefore imposes a disproportionate burden on ABS regulators who should have the flexibility to align reporting requirements with those for non-ABS authorised providers – ie report a material failure to comply.

23. Furthermore, the requirement under this section has seemed to us from the outset excessive in the context of the potential risks involved. In particular the appointment of a HOLP provides a focus point for compliance which enables minor issues within a firm to be dealt with on a semi-independent basis and for the firm to develop its own response mechanisms to prevent further breaches. The automatic reporting also could be resulting in minor breaches not being raised with the HOLP thus inhibiting better quality developments within a practice.

24. It seems to us putting the ownership and judgement more squarely in the hands of the HOLP will help that officer be more effective in managing risk within a practice, and reduce considerably the time he would otherwise spend in framing a referral and for the licensing authority to respond to it. It would also encourage an ABS to be more proactive rather than defensive in the way it manages regulatory risk.

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

25. Whilst we would agree with this approach, we believe this needs to be undertaken in a consistent fashion that meets the outcomes required and addresses the relativity of risks to the legal service market as a whole.

26. We would note that the way "material" can be defined can be very varied. The concept has undergone much debate in the area of audit where there is an international standard ISA320 written by the IAASB[1] and endorsed with minor modifications for use in the UK and Ireland by the FRC. This addresses the expectation of the oversight body with regard to how materiality should be approached by audit firms. There is a danger that each regulator may take very different approaches to materiality and therefore we believe that the LSB has a role like its auditing counterpart to set the parameters for how materiality should be judged, and for the licensing authorities to draw on that in drafting their own materiality framework. This in our view would ensure a more consistent and proportionate approach that upholds the statutory objectives.

[1] International Auditing and Assurance Standards Board

**Question 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) as proposed, and if so by how much?**

27. We agree this would reduce reporting and responding between firm and licensing authority on breaches considerably. For ICAEW as a recent entrant to the market, as indeed are the ABSs it licenses, it is difficult to place a value on this interaction as a saving, not least because the incidences tend to be related to the size of practice and the expertise of their respective HOLPs. As a yardstick we would expect a minimum of 10 man days per firm to be saved through this measure.

**Question 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?**

28. We are not sure which playing field level is being referred to in this question. If the yardstick is the requirements for authorised firms as against their ABS counterparts then the proposals do go some way to eliminating some of the inconsistencies. However there continue to be different rules for the handling of appeals by authorised individuals and a challenging cut off with the Legal Ombudsman (LeO).

29. In the case of LeO in theory it has extremely wide jurisdiction. Under the Act it is empowered to handle any complaint about an ABS, even if it is to do with dentistry, funerals or care homes. There is an illogicality in the scope which discourages organisations from becoming ABSs as they do not wish for that intrusion or fear complications where there are alternative dispute resolution options within their firm. Whilst we have found LeO to be pragmatic in the approach to accountancy we still find some firms preferring not to engage because other parts of their practice could come within its remit. This is not so much an issue for an authorised firm as all the principles are signed up and competent in the area over which legal service complaints should be managed. Some containment of LeO's scope by statute may be an aid to removing such reticence.

30. A second area where there is a lack of level playing field is in the area of privilege, which as a consequence of the Act can apply partially through a licensed firm either through the Authorised Individuals securing statutory privilege under section 190 of the Act, or through the Legal Professional Privilege of solicitors who join an ABS and bring that with them. The consequence is somewhat confusing for the consumer for whom privilege may or may not be given within a practice depending on which principal he is dealing with. An authorised firm in most cases does not have this inconsistency. The role of privilege generally perhaps requires wider consideration and therefore may be outside the scope of this immediate initiative.

**Question 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.**

31. We have drawn attention to two aspects contained within the legislation in paragraphs 29 and 30 above. We do not have anything further to add.

**Question 13: We would welcome additional data or evidence in relation to these proposals, in the light of which the cost assessment will be revised and published with the government's response to this consultation.**

32. In so far as we have been able to determine an estimate, we have given it in response to the questions above. We are not sure there are any further items to add.

**Question 14: We welcome your views in terms of any potential equality impacts of the proposals. Are there other ways these proposals are likely to impact on race, sex, disability, sexual orientation, religion and belief, age, marriage and civil partnership, gender reassignment or pregnancy and maternity that you are aware of? If so please tell us how, together with any supporting extra sources of evidence.**

33. We are aware of two issues under the legislation, particularly relating to the existing ownership rules under Schedule 13. It would appear that children and newly born babies could require fit and proper tests and even DBS checks under the schedule as it stands simply because they are heirs of a recently deceased principal. The introduction of risk and proportionality measures mean that such stressful enquiries can now be averted.

34. Secondly there are issues around the fit and proper tests relating to transgender principals and owners where records relating to the previous gender are required to be destroyed under the Gender Recognition Act 2004. Relaxation of the rules around ownership of ABS means that these individuals have little scrutiny of their previous lives which may conflict with the outcomes sought by the legal services legislation. It may be that some amendment to section 22(4) of the Gender Recognition Act 2004 may be appropriate to ensure enquiries and disclosures can be made between regulators to uphold the objectives of the Legal Services Act, whilst upholding the confidentiality objectives of the Gender Recognition Act.