THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

18 August 2009

Our ref: ICAEW Rep 85/09

Mr James Hutchinson
Legal Services Board
7th Floor, Victoria House
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By email

Dear Mr Hutchinson

"WIDER ACCESS, BETTER VALUE, STRONG PROTECTION"
Discussion Paper on developing a regulatory regime for alternative business structures

The Institute of Chartered Accountants in England and Wales (the ICAEW) welcomes the opportunity to comment on the Discussion Paper " Wider Access, Better Value, Strong Protection" discussion paper published by the Legal Services Board (LSB) in May 2009.

We believe the issues raised in the Discussion Paper and this response demonstrate the need for urgent and high level dialogue. We welcome the opportunity to take this forward with the LSB as soon as possible.

MAJOR POINTS

Introduction and offer of support

The Institute has

- an overriding duty to act the public interest; and
- skills as a regulator of firms of all sizes

Both are critical to the legal services debate and the Institute offers its full skill, experience and assistance to the LSB.

Regulation and structures

It is in the consumer interest that ABS structures are allowed to form freely and fairly, and regulation responds to market developments, rather than the reverse.

However the Institute is concerned that current regulatory arrangements will inevitably influence the formation and operation of ABS. This will encourage workaround arrangements and distort true competitive forces.

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Given our regulatory background and experience, we advocate that the LSB

- examines the impact of additional or excessive regulation upon firms which may wish to enter the reserved legal services market, but are already regulated, and either wish to retain existing regulation or *must* retain it .For example firms which are compelled to maintain FSA registration, or accountancy firms providing audit services will be at a positive disadvantage. Indeed this could be a strong deterrent for existing participants to enter the market at all. It may not act in the consumer interest to give certain new entrants (who are unregulated and/or unqualified and who may lack relevant experience and ability) an easier entry and then reduced regulation
- ensures that regulation is risk based and proportionate, particularly in the case of a true multi disciplinary practice wishing to supply legal services to consumers. The LSB should consider the business impact for a small firm with a solicitor, accountant and financial advisor with three regulators , against a "Tesco" backed law firm with just one
- as a corollary of this point, the LSB should ensure that potential new providers of legal services or their regulators are not given an immediate economic and positional advantage over existing providers and it should determine the potential effect of erosion of regulatory quality upon consumers. For example a legal executive regulated by the CLC could set up business with other unqualified professionals and opt for umbrella regulation by ILEX. Consumer protection could be better were this firm to be regulated by an accounting professional body
- approaches non approved (as well as approved) legal services oversight regulators and asks them to identify potential ABS structures attractive to consumers
- 'stress tests' identified ABS structures with all relevant regulators, and then responds as appropriate to secure a level playing field for existing and new entrants

To help commence this debate, we have set out some potential ABS structures and the implications arising from them in the Appendix to this response.

Restrictive practices

Current restrictive practices and common law developments (on this point see the Agassi case referred to below) will impact directly the potential provision of legal services.

We encourage the LSB to identify such practices as a preliminary measure, ensuring there are no pinch points which may affect market opening or cause distortion, and then considering means by which they can be removed. Cogent examples include

- restrictions on rights of solicitors to provide services direct to clients other than within a solicitors practice. For example a solicitor practising in an accountancy firm cannot be held out to clients as a solicitor and must be described as a "lawyer" providing legal services to the firm
- restrictions preventing cost recovery following the Agassi v Robinson case (2004 EWCA Civ 1518) in which the taxpayer was unable (despite the sympathy of the court) to recover accountants costs, but would have been entitled to recover had the same work been undertaken by a solicitor. This leads to artificial arrangements where accountants instruct solicitors to instruct the barrister purely as an administrative exercise to protect cost recovery – this cannot be in the consumer interest, and is unnecessary. This issue is examined in a note prepared by the Bar Council [1]and we are happy to debate the issue specifically with the LSB.

[1] see http://www.barcouncil.org.uk/guidance/recoveryofcostsinnon-solicitorcases/

Further help

The Institute is probably the biggest oversight regulator of non reserved legal services after the Solicitors Regulation Authority; as these services are already a large part of the work of accountants. Other regulators participate as well, covering such professions as surveyors, architects and actuaries.

Accordingly we would welcome the opportunity to provide formal and informal input, provide such other assistance as may be considered appropriate, and participate in the Legal Services Consumer Panel.

The Institute's formal responsibilities

Our overriding duty to act in the public interest means we do not act solely in the interest of our membership, unlike some other professional bodies. The size and nature of our membership means we understand

- the demands of 'large scale' regulation with a risk based and proportionate approach; and
- practical issues faced by firms (from sole practitioners through to multi national organisations) struggling with sometimes conflicting regulatory and client imperatives

The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council (FRC). The Institute is also a Designated Professional Body under Part XX of the Financial Services and Markets Act 2000 and a Recognised Professional Body under the Insolvency Act 1986. In all three roles we undertake statutorily derived registration and monitoring functions, under the oversight of a government or quasi-government body. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 132,000 members in more than 165 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained.

Our responses to specific questions raised in the discussion paper and an Appendix of potential ABS structures follow.

We stress again that an urgent and high level dialogue should be initiated between the LSB and the Institute, and we look forward to hearing from you as soon as possible.

Yours sincerely

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RESPONSES TO SPECIFIC QUESTIONS/POINTS

Question 1 – what are your views on whether the LSB's objective of a mid 2011 start date for ABS licensing is both desirable and achievable?

Question 2 - How do we ensure momentum is maintained across the sector towards opening the market?

We believe that the targets set for the LSB are highly challenging, but the avoidance of delay is important in the interests of the consumers of legal services, which is one of the main objectives of the Act. For firms, the ability to adopt new and innovative means of delivering services will also be of benefit to consumers.

Only by the continuing commitment of all parties will the necessary momentum be obtained. This may require pragmatic approaches to problems as they arise which should not be bound by an overly legalistic and controlling approach.

The Institute is willing to provide full support to the LSB in the delivery of this objective. A considerable amount of further work is required in key areas identified above of:

- Potential regulatory overlap
- Relaxation of current restrictive practices - which we have already considered in the Major Points section of this response and our response to *question 7*.

Question 3 –what are your views on whether the LSB should be prepared to licence ABS directly in 2011 if necessary to ensure that consumers have access to new ways of delivering legal services?

We consider the only way for the LSB to maintain momentum is for it to be prepared to license ABS directly from 2011.

We suggest the LSB concentrates in the shorter term on areas where the likely results will have the:

- Greatest and swiftest effect on consumer choice; and
- Least risk of consumer harm.

Two suitable areas are:

- Entities already identified as 'special bodies' under section 106 of the Act, particularly 'low risk' bodies; and
- Those bodies already subject to regulation or professional oversight.

This principal could be further controlled by limiting direct registration to categories where the professional bodies concerned already have statutory obligations in respect of whole firm regulation or supervision, and which act under the remit of an appropriate Government founded oversight regulator. This would include ABS led by entities regulated by the FSA, the Charity Commission, the Institute and a number of other professions and regulated bodies.

Question 4 – how should the LSB comply with the requirement for appropriate organisational and financial separation of its licensing activities from its other activities?

In the shorter term (by limiting its ABS licensing activities to the sectors identified above) the LSB could also avoid or delay any perceived or actual difficulties or expense required to separate its licensing activities from its other activities by the delegation of appropriate activities to existing whole-firm regulatory authorities.

We are not aware of any statutory or other restrictions that would prevent the LSB from taking this approach, and we believe that it would be fully consistent with their general power to take action under Part 7 of the Act, to facilitate the carrying out of its functions.

From our own experience, bodies find it more difficult to successfully separate representative and regulatory functions where resources are limited.

One solution to this resourcing issue could be for the LSB to establish a small committee of independent members, drawn in part from other relevant regulators. Once established, the remit of this committee could be to:

- act as sounding board for potential conflicts of interest and help the LSB establish a policy to deal with them; and
- provide such assistance as the LSB may require from time to time

The Institute is happy to participate further if asked.

Question 5 – how do you expect the legal services market to respond and change as a result of opening the market to ABS?

It is impossible to predict the response at this stage. The market will respond to this enabling legislation in the way it thinks fit, which may not be the way legislators intended, particularly if the implementation of the Act is seen as burdensome.

However it is important to evaluate potential pinch points that may affect market opening or which might cause market distortion. Cogent examples we have already identified include:

- restrictions on rights of solicitors to provide services direct to clients other than within a solicitors' practice;
- restrictions preventing cost recovery in litigation

It should also be borne in mind that the legal services market may change very little, particularly if current restrictions continue into the future.

We mentioned earlier that it may be a good idea for the LSB to ask all potential participants (ie not just current approved legal services regulators) to produce models of likely ABS and 'stress test' them. Perhaps they could also be asked to identify restrictive practices or pinch points, and assess their potential impact, at the same time.

Question 6 – in what ways might consumers of all types- including private individuals, small businesses and large companies – benefit from new providers and ways of delivering legal services?

As stated earlier, accountants already provide a significant volume of unreserved legal services. This includes legal services to individuals (for example in managing their tax affairs), but in particular and, indeed to a degree not generally appreciated, to businesses of all sizes

A relatively free market in accountancy and related services has already led many accountancy practices into the provision of a very wide range of professional services, including with such diverse professionals as actuaries, forensic investigators, property professionals and corporate financiers. We see no reason why such market led service efficiencies would not also extend to the provision of reserved legal services, once an appropriate regulatory structure is in place. This would benefit consumers at every level.

Question 7 – what opportunities and challenges might arise for law firms, individual lawyers, in house lawyers and non lawyer employees of law firms as a result of ABS?

Fair competition will tend to strengthen the legal profession in the UK, not to weaken it.

Current restrictive practices in the legal profession, for example preventing a solicitor from being held out as a solicitor to clients unless working in a law firm, may continue to operate to restrict the potential opportunities for lawyers and non lawyer alike in certain potential ABS models.

In the case of chartered accountants providing services as employees of a law firm, they can continue to describe themselves as chartered accountants and are under the professional oversight of the Institute.

A law firm cannot offer the same professional recognition and designation to a chartered accountant. This inevitably has an impact on career progression and is anti-competitive.

However, we believe that generally opportunities will open for individuals and firms to develop new structures.

Question 8 – what impact do you think ABS could have on the diversity of the legal profession?

At the firm level, a well planned and regulated ABS framework is likely to benefit the consumer of legal services as other competent (and diverse) providers can participate. This will encourage diversity as a variety of business models enter the market. At the individual level, the Act cannot of itself change attitudes that may have prevented diversity of opportunity, but it can act as a catalyst, as new providers of legal services bring new ideas into play. However, bureaucratic attempts to enforce diversity targets are likely to be counter productive.

Question 9 – what are the educational and developmental implications of ABS and what actions need to be taken to address them?

We are not aware of any particular educational or developmental implications on behalf of the HoLP and HoFA, or the owners and managers of ABS that are not already covered by existing requirements for professional competence, Indeed, setting artificial hurdles for such individuals will act as a barrier to the developments and improvements that ABS are meant to bring.

It is inevitable that with the emphasis on reserved legal services, educational efforts will in some cases be directed at specialisation from an early stage. This may alter the breadth of training provision, in the same way that audit exemption for companies has reduced the training opportunities for new auditors.

Nevertheless we believe that encouraging the participation of chartered accountants within ABS, with their ethos of robust and continuing training, can help immensely on this particular issue.

Question 10 – could fewer restrictions on the management, ownership and financing of law firms change the impact upon the legal services sector of future economic downturns?

Yes. A more competitive market for legal services will encourage a more efficient legal services sector, and hence make the sector more robust in future economic downturns. For example high street law firm may lose conveyancing work to low cost 'consolidators' but could join with a chartered accountant in an ABS and cross-sell work to the accountant's clients such as advice on wills and probate.

The counter view is that new business models will have different drivers that may mean they react differently in economic downturns and withdraw from the market more rapidly than may be the case at present. Both perspectives are tenable, but the key is that any restrictions on management etc should be finely weighed as to what they are trying to achieve. *Question 8* referred to diversity in the legal profession and that it is just as important from this perspective.

A possible exception to this effect could be in the area of publicly funded legal defence and civil litigation work. This is not our area of specialism, but we are aware that these publicly funded services are not subject to the strengthening effects of market finances, but may well be subject to pressures due to public funding limitations.

Question 11 – what are the key risks to the regulatory objectives associated with opening the market to ABS and how are they best mitigated?

Key risks could include a failure to take into account:

- the professional and commercial arrangements that already exist for unreserved yet overlapping legal services, as set out above: and
- the appropriate regulatory framework needed to allow all ABS providing reserved and unreserved services to compete on an equal basis , irrespective of their constitutional make up and history

We cannot believe it was the intention of Parliament to draft the Act in a way which subjects some of these new entities to unnecessary dual regulation. Without further considered debate on the potential constitutional makeup, history and business operation of an ABS, it may be the unintended result.

It is contrary to the BERR Principles of Good Regulation which require regulators to take account of existing regulations, and for regulators to be mindful of 'unintended consequences' in one area by regulating in another.

The Institute is fully committed to debating this issue with the LSB and other stakeholders.

Clearly, with an objective of opening up the market, there is the danger that the market may develop differently in the future to what is has in the past. There is a danger that 'consolidators' and other large entrants into the market will drive changes in the overall provision of reserved legal services such that for some sectors of society, that provision is reduced. However, the more open and less restricted the market is, with reduced barriers to entry, the more likely that solutions to these problems will come forward.

Q12 – are there particular types of business structure or model which you consider to present a particular risk to the regulatory objectives?

It should not be the role of the LSB to restrict the models that may be adopted. Rather it is a question that the oversight of those models responds to the risks that may be posed. For example, if an ABS is owned by a company that has a different but perhaps complementary service range (eg audit) then special attention may need to be paid to conflicts of interest. While this is an increased risk, the auditors' ethical code already deals with such matters, so it is only a question of reviewing that the implementation of the code has responded to the new threats.

Question 13- what conflicts of interest do you think might arise in relation to ABS and how should they be managed?

For accountancy led ABS, or for ABS within which accountants work as minority service providers, we do not see the possibility of any significant conflicts of interest arising which are not already possible under existing structures for the provision of legal services.

Legal professional privilege
We are aware that there may be a number of areas of potential conflict of law or regulatory practice. For example, legal professional privilege will impact differently on different professionals acting within an ABS. We are sure though that this will not be an unmanageable conflict since it only requires an awareness of which professional is providing which services to which clients and for conflicting services to cease.

Audit issues
We have heard it raised that firms in an audit relationship with a client have different objectives and responsibilities to that of a lawyer with his client. An auditor defines his client as the company in general meeting, that is the body of shareholders. A lawyer typically defines his client in far narrower terms and hence treats information as confidential to a narrow audience and it is not put on the public record as is the case with audit conclusions.

However, this is unlikely to result in conflicts of requirements for client service, due to the strictness of the requirements for auditor independence. Auditors are not permitted to provide other services to their clients, which will influence the client performance which will be subject to their audit. Thus only the most marginal of legal services of any kind are likely to be able to be provided to an audit client of an ABS.

In the case of any other service provided by an ABS, it is true that the ethics of a professional accountant are differently derived and have a somewhat differing emphasis to that of a lawyer, but none of these would result in an unmanageable conflict. For example, the over-riding characteristic of the accountancy profession to take into account the public interest, can be equated with the legal profession's duty to act primarily as an officer of the Court. The key requirement for both professions is the requirement to act with integrity.

Business conflicts
These could arise as a result of regulatory overlap and restrictive practices directly affecting some ABS but not others.

This could have a direct business impact on affected ABS attempting to comply with assorted regulators, and disadvantage ABS structures which fall within this particular category (perhaps as a result of restrictive practices demanded by some regulators and not others).

Memoranda of understanding between regulators would reduce this business conflict and could also clarify arrangements and responsibilities for complaints handling which can only assist consumers.

Question 14 – how should licensing authorities approach entity based regulation and what are the main differences from the traditional focus on regulating individuals?

The Institute has a number of levels and types of professional and regulatory oversight over members, non-member individuals acting as managers or controllers within our member firms, or member firms and other entities. This results in a very extensive and flexible suite of powers which we can utilise in oversight of our members or our member firms. We commend a similarly wide and flexible suite, to the LSB and the front line legal service regulators, and would be happy to discuss how we have developed them ourselves.

These functions include:

- professional and disciplinary oversight of all members, wherever they work;
- assurance that members practising whether within or outside one of our members firms, is doing so under appropriate systems and arrangements, under our 'practice assurance' arrangements;
- professional and disciplinary oversight over 'affiliates' who are individuals who take on management or ownership positions (or partnership) in one of our member firms.
- regulatory control of firms which are regulated auditors, or carry out investment business, under Section XX of the Financial Services and Markets Act;
- whole-firm supervision, under the *Money Laundering Regulations 2007*.

A key aspect of the difference is an emphasis on the internal systems and procedures that a firm uses to ensure that it continues to provide high quality work.

Question 15 - do you agree with our view that licensing authorities should take a risk based approach to regulation of ABS and if so how might this work in practice?

Yes. A risk based approach is most effective, with proportionate and detailed regulation for specific issues/ areas of high risk. We would suggest that the LSB talks to other experienced bodies with experience of, and interest in, risk based regulation.

For our part, the Institute is happy to provide such support and the benefits of its own experience as a risk based regulator. In particular we have a Quality Assurance Department which is responsible for the review of over 11,000 firms of chartered accountants, ranging from the 'big 4' to sole practitioners.

Question 16 - what is your preferred balance in regulating ABS between a focus on high level principles and outcomes and a more prescriptive approach?

We believe the LSB should focus on high level principles regulation.

Question 17 – what are the advantages and disadvantages of a requirement on ABS to have a majority of lawyer managers?

A requirement on ABS to have a majority of lawyer managers would completely outlaw the possibility of the existence of ABS with a majority of other equally well regulated professionals. This would radically reduce the possibility of innovative models coming forward for no good reason with, in our view, a consequent disbenefit to the consumers of legal services.

Question 18 - what are your views about how licensing authorities should determine whether a person is a fit and proper person to carry out their duties as a HoLP or a HoFA?

We note that the SRA Consultation on 'Character and suitability tests for non lawyer managers of an LDP' concluded that non lawyer managers should be subject to the same principles of character assessment and suitability as solicitors.

We believe that character and suitability tests for non lawyer managers who are acting as a HoLP or a HoFA should be no less rigorous than for a lawyer, but that they should be equivalent, rather than the same.

Members of other professional bodies are subject to rigorous ethical and competence requirements that differ in detail from those of lawyers, but are identical in what they are trying to achieve, namely the protection of the recipient of the services. To require professional accountant HoLPs or HoFAs to comply with both sets of principles is unnecessary and inappropriate.

Question 19- what is the right balance between rejecting higher risk licensing applications and developing systems to monitor compliance by higher risk licensing bodies?

In our view, this would turn on the particular circumstances of the case and the elements of the application that are viewed as high risk. It may be the case that the risk cannot be mitigated, eg an application from a firm in which an individual with a criminal record is involved. In other cases it may be that a simple adjustment to the application resolves the problem, or subsequent monitoring of the applicant is sufficient.

We would expect that the involvement of a chartered accountant in an ABS would normally reduce, rather than increase, risk to consumers or the public interest, compared with people without a professional qualification. The reliance that can be placed upon the skill set and ethics of a member of a professional body can help underpin the principles of good regulation.

Question 20 – how should regulators ensure a level playing field between regulated legal practices and licensed bodies?

One of the main thrusts of the Act is to act in the public benefit, and thereby encourage open competition for the supply of legal services. It is very important for a level playing field to be maintained between regulated legal practices and licensed bodies, if this objective to be achieved.

While it is possible that requirements on a licensed body may be different to those on a legal practice, these should be capable of justification. However, our view is that a requirement, for example that a firm has professional indemnity insurance, should apply equally to a regulated legal practice and a licensed body. Any such differences should not be such as to restrict one mode of operation over another and it would seem that this is a role for the LSB when reviewing the rules of regulatory bodies.

We reiterate again the points made earlier in this response on the impact of additional or excessive regulation upon firms which may wish to enter the reserved legal services market, but are already regulated, and who wish to retain existing regulation or must retain it. This could be a strong deterrent for existing participants to enter the market at all.

Indeed it could be that equal rights of entry are given but thereafter it may not be in the consumer interest to have new entrants who are unregulated and/or unqualified and who may lack relevant experience and ability. We consider it is important that these two issues are looked at together and not in isolation.

Nevertheless, opportunities exist for the continuation of existing unnecessary restrictive practices (or the introduction of new ones), within the regulatory requirements for ABS. The Institute is concerned that any increased regulation on accountancy led ABS will be anti competitive and put accountants at a positive economic disadvantage to lawyers. Some of the possible ways in which this could happen are explored elsewhere in this response.

The Institute believes this important area requires further informed debate and analysis in which it is happy to participate.

Question 21 – how should licensing authorities approach the access to justice condition and do you agree it unlikely that many licences should be rejected on the basis of the condition?

'Access to justice' is an ill-defined term. Does it mean geographical access or access regardless of the position of the potential client. If the former, it can never be a licensing criteria, if the latter then it is very difficult to judge as access in this case is governed by cost. Among the current threats, there is a danger that smaller legal practices will act under a competitive disadvantage, due to the inability to share overheads (and fees) with other service providers. Equally, a large ABS may in any event have costs that mean its pricing structure puts it beyond the means of many. The formation of an ABS with other local professionals could help mitigate this effect, and thus tend to improved access to justice.

For this reason alone, we think that the introduction of appropriately regulated ABS should be brought into force with the minimum of delay, including accountancy led ABS as well as lawyer led ones. We would add that many of our firms (and firms of solicitors) undertake pro-bono work and that is likely to continue. However, we cannot see that a licensing authority can regulate for a firm to allow access to all potential clients. That is a political objective which would have to be dealt with in other ways.

Question 22 – how should licensing authorities give effect to indemnification and compensation arrangements for ABS?

In so far as possible under the statutory limitations, both indemnification and compensation arrangements, and complaints handling arrangements, should follow the existing arrangements for

the majority of the controllers or managers for the ABS, where these exist in a formal regulatory or professional format.

Thus these should follow FSA requirements for an IFA led ABS, and professional requirements for an accountan*t*-led ABS.

However, as the FSA has already found, it is not possible to require the insurance market to insure entities that it regards as a risk. While the assigned risk pool (ARP) concept works, it could be overwhelmed in the case of a market crash or some other systemic failure, as would a mutual which from a risk perspective should have reinsured itself in the market.

But it should be noted that the ARP operated by the Institute has never, in all its years of existence, had more than 15 firms in it, from a potential population of accountancy firms of well over 11,000. Our experience is that if a firm enters into a sensible discussion with a broker and insurer, then insurance is generally forthcoming. Premiums tend to be driven by claims history, rather than any perception of one operating model is better than another.

We agree that it is not appropriate to set capital adequacy requirements for firms. These are unlikely to operate in the way intended (to allow an orderly run down of the firm) and onerous requirements would be a barrier to entry.

We have not experienced significant problems with clients' money but we are aware that other professions are in a different position. We would suggest that a way of dealing with this issue, in the absence of a compensation scheme which in reality makes the good pay for the bad, is to require higher PII for those firms holding clients' money or the holding of a bond that pays out in the event of a defalcation.

Question 23 – how should complaints handing in relation to legal services provided by ABS be regulated?

We agree that complaints handling requirements for an ABS should be no different to that of other market participants. However, we believe that those part of the arrangements that extend to the Office for Legal Complaints should only apply, on a mandatory basis, to complaints about reserved legal services. Otherwise there is not a level playing field with the providers of the other services that the ABS may provide.

It would be open to the Office for Legal Complaints to set up a voluntary scheme, as the Financial Services Ombudsman has done with its 'voluntary jurisdiction', which then becomes a mark of best practice.

Question 24- how should licensing authorities approach the fit to own test and how critical is that in mitigating the risk to the regulatory objective of promoting lawyers adherence to their professional principles?

We have not considered a response to this question in detail, since we consider that ownership of an ABS by a chartered accountancy firm would not have any deleterious effect on lawyers' adherence to their professional principles. For accountant owners to reduce compliance with the professional requirements in an ABS owned by them, would be a breach of their own requirements for integrity.

If licensing bodies were to impose unnecessary restrictions on the owners of ABS, which are themselves subject to alternative but adequate professional or regulatory requirements, this could represent an unnecessary regulatory burden, which could unnecessarily restrict the development of alternative provision of legal services.

Question 25 – are there any particular risks to the regulatory objectives that arise from an ABS offering non reserved legal services?

It is a general principle of the LSA that firms which only provide unreserved legal services fall outside the remit of the Act. Any requirements on ABS that only provide unreserved legal services arise only from the rules of a specific professional or regulatory body, not from the provisions of the law on the regulation of legal services. This is an area where the continuation of unnecessary restrictive practices, or the introduction of new ones, could be particularly damaging to the widening of the provision of legal services.

For ABS that provide both reserved and unreserved legal services, it is our view that the licensing bodies should have overall responsibility for the provision of the reserved legal services. Responsibility for the unreserved legal services should depend on the individual providing them, or supervising their provision. Thus, accountants providing tax advice within an ABS should continue to answer to the disciplinary oversight of the Institute, and an IFA advising on legal matters relating to investment should do so under the regulatory oversight of the FSA.

It may well be appropriate for the HoLP to have overall responsibility for the fair provision of all legal services in a mixed ABS, particularly in relation to service providers with no professional or regulatory affiliation. Where this lead to conflicts in regulatory requirements or approach in relation to unreserved legal service provided by (say) an accountant, the various regulatory bodies should be required to act in cooperation with each other, with a view to reaching the fairest and most cost effective regulatory outcome.

The Institute see no particular risks arising from an ABS offering non reserved legal services. Accountants have provided them successfully for many years. The average consumer is unaware of the difference anyway and will look to the firm to resolve any problems in the first instance.

Question 26 – what are the risks to the consumer associated with the delivery of legal services by special bodies and which more general risks are relevant to these bodies?

We are not aware of any particular risks to consumers of legal services provided by trade unions, non-profit making bodies, or legal practices provided by firms with a large majority of lawyers acting as owners or managers.

However, we cannot see that a licensing authority would wish to license a special body and in our view, these will fall to the LSB, to the extent that they offer reserved legal services to their members or the general public in the case of the Citizens Advice Bureau. This we doubt would be the case and it would seem sensible if the LSB engaged directly with them, as it appears to have done with the trade unions, to establish if any more work is needed in this area.

If a more relaxed regime is be extended to ABS with a large majority lawyers, we consider that a similar approach should apply in cases where other appropriate professionals or regulated persons, such as professional accountants hold a majority and the level of reserved legal services is low in relation to the size of the firm. This could be similar to the Designated Professional Body arrangements of Part XX of the Financial Services and Markets Act 2000, which allows firms of accountants to undertake a limited range of investment business.

Question 27 – is it in the consumer interest to require special bodies to seek a licence and of so what broad approach should licensing authorities take to their regulation?

As mentioned above, the position of special bodies (other than ‘low risk’) needs separate consideration. The only likely licensing body would be the LSB, assuming that special bodies provide reserved legal services, which is unlikely.

Question 28 –are there any other issues that you would like to raise in respect of ABS that has not been covered by previous questions?

We have no other specific issues to raise at this time, but we would be pleased to provide the LSB with further information on our own provisions for the regulation of firms, our oversight of the activities of our member firms or any other matters.

We recommend that the LSB talks to other regulators, in particular those who are not reserved legal services regulators but whose members already provide non reserved legal services and/or may be interested in forming or joining an ABS.

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THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

APPENDIX

LSB ABS Case Studies

Example 1

3 sole practitioners, a solicitor, a chartered accountant (FCA) and an IFA wish to join into partnership, for mutual support, client service and overhead savings.

Hub and Spoke

The three individuals set up a holding company in which they each take shares in exchange for ownership of their respective practices. These new subsidiaries are regulated in much the same way as previously – the IFA by the FSA, the FCA by the ICAEW and the solicitor by the SRA. The FCA will continue to require a Practising Certificate and be subject to ICAEW Practice Assurance requirements (including routine monitoring visits on a rolling basis, to check that appropriate procedures are followed). The solicitor's practice converts to an ABS, under the ownership of the holding company. It is licensed by the SRA, and complies with their requirements as if it was still a standard legal practice.

With this model each subsidiary will need to have their own procedures, including accounts engagement letters, complaints, regulatory and liability considerations. Clients may be confused, particularly with the differences in engagement letters and in the issue of which entity they are dealing with at any one time. This could confuse and complicate complaints management. Many of the hoped for administrative efficiencies will be lost, for these reasons.

Single ABS Licensed by SRA

Alternatively, the three individuals could set up a single entity, jointly owned, and licensed by the SRA as an ABS. This would considerably simplify the administrative procedures, and clients would have a single entity to deal with.

However, the regulatory issues, certainly so far as the FCA was concerned, would be considerably complicated. The FCA will continue to require a Practising Certificate from the ICAEW and be subject to ICAEW Practice Assurance requirements. Complaints about the work of the FCA would have to be dealt with twice, once according to his own professional affiliation and once under the remit of the OLC.

The three individuals could considerably simplify their regulatory and compliance costs were the FCA to resign his membership of the ICAEW and continue in practice as an unqualified accountant acting within the ABS, under the sole regulatory remit of the SRA. However, the SRA does not have experience of the regulation or disciplinary oversight of accountancy work, and it is never likely to be its main focus. There is therefore likely to be a weakening of the overall oversight of the services afforded to the clients of the former FCA. Not only this, but other users of client financial statements and other information produced or supported by the work of the former FCA, such as creditors and other trading partners, HMRC and the banks and other lenders, would have their assurance of the output of the accountant weakened. Both outcomes are counter-intuitive to the overall aim of the Act.

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Example 2

2 partner firm of solicitors is in financial difficulty and is bought by a local 8 partner firm of Chartered Accountants

Accountancy firm purchases the Solicitors Practice, and maintains it as an ABS Subsidiary

In this scenario the regulatory complications would be kept to a minimum, and both solicitors and accountants could continue their business activities as before. However, administrative efficiencies would be reduced, as with the hub and spoke example above.

Accountancy firm takes the 2 solicitors into partnership as an ABS licensed by the SRA

For the accountancy practice to take the two solicitors into partnership, the whole firm would need to be licensed as an ABS. This would mean that the two solicitors could continue to undertake reserved legal services, but tax and general business advice carried out by the eight chartered accountants would often come within the definition of unreserved legal services, and would thus come under the oversight of the HoLP, and the full regulatory remit of the SRA. We assume that in this scenario, the two solicitors could continue to describe themselves as such, though this is not currently clear to us. This represents unnecessary dual regulation of the accountancy services that have been provided by the chartered accountants for many years. In addition, all the services provided by the whole practice would be subject to complaints being referred to the Office for Legal Complaints, even though client complaints against the services of chartered accountancy practices are very much fewer in number and have not raised the concerns that complaints against solicitors' practices have.

As the firm still has a majority of partners who are members of the ICAEW, and provides accountancy services, they cannot resign from the Institute's whole-firm oversight – including practice review and anti money laundering supervision.

If the firm wishes to use the description 'chartered accountants' or is a registered auditor, the solicitors will need to become associate members of the Institute, and become bound by the Institute's Ethical Code and disciplinary oversight. If the accountancy firm is a registered auditor, further complications will arise, due to the impact of audit independence requirements, and other whole-firm audit regulations.

Accountancy firm takes the 2 solicitors into partnership without becoming an ABS

Alternatively, the two solicitors could resign their status, and act as partners in the firm as non-solicitor lawyers. The restriction on their designation is not due to any legislative provisions, but due to restrictive Law Society Rules. The lawyers would therefore act without the oversight of the SRA or any other legal services regulator. This may be adequate to the needs of clients, as the firm will still be subject to the Institute's oversight, but will change the ethical and regulatory oversight of the work of the lawyers.

Under the provisions of the *Legal Services Act*, the two lawyers would have to cease the provision of any reserved legal services, so that the whole firm provides unreserved legal services only. This would represent a reduction in the provision of reserved legal services, again, counter to the overall aim of the Act.

Example 3

Large accountancy practice with a national and international reputation for corporate finance, tax and general business advisory services finds itself in direct competition with large law firms, which have developed their services in these areas having been able to attract top class accountants with the offer of full partnership

In the future, top law firms will be able to offer partnership status to world class accountants, providing a full multi-disciplinary practice, without having to undergo dual regulation, except to the extent that the chartered accountants involved remain under the disciplinary oversight of the ICAEW.

Top accountancy firms, in contrast, will not be able to offer full partnership status to solicitors (acting for clients, as such) without forming an ABS with very considerable cost implications arising from dual regulation. In practice, the accountancy firm is more likely to form a separate ABS law firm, as a subsidiary. This will have similar costs arising from the administrative complexities, and potential confusion, as arises in the case of smaller firms. Individual world class accountancy advisers may transfer to law firms, in order to be able to work in closer partnership with world class lawyers, and with simpler relationships with clients requiring the services of both a lawyer and an accountant.

This lack of a level competitive field will necessarily damage the market in the provision of legal services, with an unfair advantage being available to large law firms over large accountancy firms. This will tend to prejudice the interests of clients, whose decision making will be influenced by factors other than the most efficient and effective provision of services. Over time, this effect may also reduce the diversity of the provision of legal services, if the provision of general professional services from accountancy firms becomes uneconomic.

Implications and Possible Mitigation

The ICAEW is very willing to discuss its own professional requirements, in agreement with our own over-sight regulator, the Professional Oversight Board (one of the operating bodies of the Financial Reporting Council) with a view to removing unnecessarily duplicated requirements.

The impact of dual regulation could be considerably mitigated by agreement and common working between the various regulatory authorities. Notwithstanding the detail of the statutory requirements of the *Legal Services Act*, we see no reason why one regulator might not delegate part of its regulatory remit to another, by non-statutory agreement. Without such agreements, we cannot see how a number of the regulatory objectives of the Act can be fully achieved. We suggest that the LSB should promote such agreements, supported by Memoranda of Understanding between the various regulatory authorities, under the oversight of the LSB and other relevant oversight bodies.

In an ideal world, all firms subject to diverse regulatory requirements would have a single ‘whole-firm’ regulator, usually the regulator who represents a majority of the partners, or work, of the firm. This regulator would deal with such issues as are most appropriately dealt with across the firm, such as systems and client service requirements (including anti-money laundering compliance and reporting requirements) as well as charging issues, timely responses to client needs, and requirements for governance and control of the firm. Apart from these whole-firm matters, each regulatory authority would deal with matters pertaining to the work carried out by, or under the supervision of, individuals within their professional or regulatory oversight.