



# FOIL UPDATE

June 2009

Update from the FOIL Annual Seminar

Will the changes in the structure and regulation of the profession lead to a 'revolution'?

At the FOIL Annual Seminar on 10 June Lord Hunt painted a picture of a profession on the cusp of great change:

- The Legal Services Board (LSB) is reported to want to see the reforms achieve "something close to a revolution" having already expressed the view that the existing regulatory regime has prevented the legal profession from "realising its full potential".
- Alternative Business Structures (ABSs) are at the heart of what the Ministry of Justice wants to achieve
- Private equity waits on the wings to 'help' law firms with capital and management.
- Major companies are eager to move into what is seen as a highly commoditised sector.

As Lord Hunt stated, even he cannot say where the profession will end up but life after 2011 will not be the same as before, particularly in the market where FOIL members operate. In particular, although at present many law firms are focussing on the effects of the recession, a raft of new challenges will arise with ABSs in 2011.

The issues FOIL members were discussing after the speech are crucial to the profession:

- Will the legal profession be undercut by professionals with less rigorous, cheaper regulatory requirements?
- How can conflicts of interest be avoided in a law firm owned by shareholders?
- Can long-maintained ethical standards within the profession be maintained in the face of private equity's drive for profit?
- What will become of legal professional privilege in a multi-disciplinary ABS?

Lord Hunt confirms in his report that the model for statutory, profession-led regulation proposed by Sir David Clementi and enshrined in the Legal Services Act 2007 "can, will and must be made to work" in the interests of the profession itself, consumers and the public interest. He indicates that the profession must ensure that it works in accordance with the regulatory regime in the Legal Services Act "lest we find ourselves on a slippery slope towards direct, statutory regulation". As Lord Hunt made clear at the seminar "we are in charge of our own destiny and need to speak out".

A short summary of Lord Hunt's 'Initial Response to the Call for Evidence' is set out below. Your views are sought on all issues, in particular:

- Reform of the SRA
- The content, tenor and general accessibility of the Code of Conduct
- The proposals for corporate firms including self-regulation
- The implications and challenges of Alternative Business Structures.

Consultation papers on the regulation of ABSs have also been published by the LSB and the SRA. These are lengthy documents looking in detail at the issues. Copies of

both are available on the website [www.foil.org.uk](http://www.foil.org.uk). Some of the very thought provoking questions raised in these consultation papers are listed at the end of this Update.

On the Lord Hunt consultation please respond to [shirley.denyer@foil.org.uk](mailto:shirley.denyer@foil.org.uk) by 26 June. The FOIL response needs to reach Lord Hunt by 30 June.

More time is available for the LSB and SRA consultations. Views and comments from members on these consultations are needed by 20 July, to meet closing dates in August. Again, please respond to [shirley.denyer@foil.org.uk](mailto:shirley.denyer@foil.org.uk)

#### [What is an ABS? \(detail from the SRA consultation paper\)](#)

ABSs enable lawyers and non-lawyers to share the management and control of a business which provides reserved legal services to the public. ABSs will allow external investment and ownership of law firms.

The minimum requirements for an ABS are:

- It must have at least one 'manager' who is authorised to provide the reserved legal activity
- It must have at least one non-lawyer 'manager' or 'owner'.

Therefore existing legal disciplinary practices with even one non-lawyer manager will need to be licensed as ABSs. At the other end of the scale commercial organisations could buy law firms or set up subsidiaries to offer legal services. Private equity could invest in law firms, firms could float on the stock exchange, lawyers and other professionals could work in one business. Even with only one solicitor 'manager' an ABS is likely to be able to use the title 'solicitor' probably with other titles. The focus of regulation will shift from the individual lawyer to the business.

#### [Lord Hunt's Legal Regulation Review – a summary of his 'Initial Response to Evidence'](#)

##### [Structure and Delivery](#)

As an initial issue, should the regulatory 'net' extend to further types of work, for example, to cover will-writing, certain commercial work, certain types of legal helpline and all probate work?

The separation between the representative and regulatory functions within the Law Society is vital. An on-going dialogue is needed to avoid 'boundary disputes'. One interesting issue is which part of the Law Society should have the power to bestow or remove the title of 'solicitor'. Lord Hunt is minded to recommend that only those who meet the regulatory requirements and subscribe to the higher professional standards promulgated by the Law Society should be entitled to call themselves solicitors, in which case the title would be in the gift of the Law Society, not the SRA.

##### [The Substance of Regulation](#)

Lord Hunt's initial consultation has revealed many concerns about the existing regime: in particular the SRA is seen as too reactive and too closely related to complaints and lapses. He notes that there are plainly aspects of the current regime which unnecessarily antagonise the profession without benefitting the consumer or the wider public interest. Perhaps the biggest question is whether and how the SRA can become more pro-active, by providing a clear vision of how a good legal firm should look, operate and behave. Lord Hunt is minded to recommend a number of proposals to reform the SRA including the development of a "comprehensive tool kit" for firms, an extension of the role of pre-emptive and advisory visits to help with compliance, and more information on the range of sanctions to achieve greater transparency of

operation. He considers that the SRA could improve its service by replacing its call centre with named individuals/groups who can provide some continuity of advice.

Responses to the consultation have hardly mentioned the Code of Conduct and more views are sought on its contents, tenor and general accessibility.

Turning to the Solicitors Disciplinary Tribunal Lord Hunt feels that their processes should be speeded up: a prolonged process can irretrievably damage reputations whatever the eventual outcome of the case. The lessons learned from SDT rulings should be "noted, learned and promulgated", on an anonymised basis if necessary.

Many submissions to Lord Hunt have raised a perception of inequality in the work of the regulator. An oft-made criticism is that SRA activities focus disproportionately on certain types of firm. More transparency might cause this view to evaporate, although smaller firms do find it harder to absorb the fixed costs caused by meeting regulatory requirements. Lord Hunt believes that it is in the public interest as well as in the interests of efficient regulation that there should be no hint of inequality of approach or practice by the regulator. No area of legal practice should be regulated more rigorously than another, unless a clear, risk-based case can be made for it. Above all, the Code of Conduct and similar rules, should be drafted and applied on a consistent basis. The sense of discrimination on the part of the regulator might be reduced if complaints about regulation could be referred to an independent impartial adjudicator. Therefore Lord Hunt is minded to suggest that a separate function be set up to handle unresolved complaints against the regulator, akin to the Office of the Complaints Commissioner in the finance sector.

#### [Appropriate Regulation: Common Principles, Varying Methods.](#)

The legal profession is characterised by numerous and overlapping codes and sets of professional and regulatory principles. Lord Hunt is minded to recommend that there be just two codes/sets of principles: one for the regulator and one for the professional body. They should complement each other and be flexible to allow the introduction of ever-higher standards over time. Views are sought on what should go into these codes.

No-one has argued for a one-size-fits-all regulatory regime but Lord Hunt indicates that the founding principles of regulation must be universal. With regard specifically to larger, corporate firms Lord Hunt is not attracted by the idea of a separate bespoke regulator for such firms but he is minded to believe that they require a different approach than that for smaller firms. He is very attracted to "mandatory self-regulation" under which firms would self-certify their adherence to regulatory requirements annually, with named individuals taking responsibility for processes and data. This would not be 'light-touch' and penalties would be severe. "It could in time become a mark of pride to be admitted to this system..., a mark perhaps of corporate maturity." The regulator should take a far greater interest not only in the services provided by law firms but also in the robustness of their internal governance.

#### [Alternative Business Structures](#)

Lord Hunt has always been concerned that ABSs should not be introduced with undue haste and he expresses some disquiet that the full regime may come into effect from as early as 2011, but we are where we are.

The first question is whether ABSs will require a whole new regulatory model. The Legal Services Board will determine the overall framework of regulation and individual regulators will resolve how to issue licences for ABSs. This is new territory and all risk assessments will be high. Should there be some kind of surcharge or levy on the first wave of ABSs to take account of higher attendant risks?

Whilst the Legal Services Board is impatient to see ABSs in place the SRA has expressed practical and logical reservations. Lord Hunt confirms that there must be no question of the SRA being forced to regulate ABSs until it feels "genuinely confident about its ability to do so, to the highest standards".

Lord Hunt is minded to recommend that all ABSs should be required to appoint a designated Head of Regulatory Affairs. This could be the senior or managing partner, the Head of Legal Practice or the Head of Finance and Administration.

ABSs in their entirety should be expected to match the ethical standards of traditional law firms, both the regulatory and the professional standards. Although it may be a culture shock to some of those involved important issues such as conflicts, client confidentiality and the handling of client money must be maintained right across the sector including ABSs. Robust requirements on good governance should ensure that only appropriately trained, qualified and supervised individuals provide regulated services to consumers. The regulator may also want to ensure that the "controlling minds" within an ABS are fit and proper. Lord Hunt is minded to recommend that, initially, the same standards of governance and mandatory self-regulation being proposed for corporate legal firms should also apply to ABSs.

The full text of Lord Hunt's Initial Response is available on the website [www.foil.org.uk](http://www.foil.org.uk)

Questions raised by the LSB and SRA consultation papers (these are just a few of the many raised in both consultation papers):

- How do you expect the legal services market to respond and change as a result of opening the market to ABSs.
- What opportunities/ challenges might arise for law firms as a result of ABSs?
- What are the key risks associated with ABSs and how can they best be mitigated?
- Do any particular types of business style or model present a particular risk?
- What conflicts of interest might arise? (*a potential conflict between insurers and lawyers in an ABS is mentioned*)
- How should licensing authorities approach the 'fit to own' test?
- Should a duty of sound financial management be imposed to reduce the risk of a collapse of an ABS?
- Is there anyone who should not be licensed to own an ABS? (*claims companies whose business includes 'cold calling' are mentioned*)
- Do some claims management companies or legal expenses insurers have an adverse interest that might prevent them acting for some clients or require additional regulation?
- Is the problem of conflict between regulators a major concern?
- How can a level playing field be maintained between regulated legal practices and licensed ABSs?
- How will the Solicitors Compensation Fund work with regard to ABSs?
- What should be the insurance requirements of ABSs? (*it is being suggested by the SRA that only legal or solicitor services should require compulsory insurance but not services which are clearly not legal, client to be informed of that*)
- Is the LSB's objective of a mid 2011 start for ABS licensing both desirable and achievable?
- What are your views on whether the LSB should be prepared to licence ABSs directly in 2011 if necessary (*if the SRA is not ready to do so*)?
- Should the SRA provide a regulatory regime for ABSs as soon as possible?

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