



THE LAW SOCIETY  
of SCOTLAND

www.lawscot.org.uk

Dear Colleague

I'm writing to update you on the work of the Society on ABSs following the Stage 1 debate and vote in the Scottish Parliament on Wednesday 28 April. It was clear from the debate that the Legal Services (Scotland) Bill has cross party support but there is a need for amendments to the Bill which the Justice Committee will progress at Stage 2.

There are clearly differing views in the profession on the percentage of external ownership which ought to be permitted by statute and, indeed, the percentage of external ownership permissible in any Licensed Legal Services Provider (LP), as ABSs are referred to in the Bill, regulated by the Society. The Society will continue work towards agreement on a compromise which can be accepted by the profession at our AGM in May. There are now a number of options for compromise being discussed across the profession and that is in itself, good news.

In the ABS referendum however, members gave the Society a clear view on the future regulation of ABSs. 81% of respondents said "YES" to the question "In the event that the Legal Services (Scotland) Bill enabling ABSs to operate as an LP is passed into law, should the Law Society of Scotland apply to be a regulator of such LPs?"

As a result the Society is continuing to develop the key principles for a regulatory scheme and we will propose amendments to the 1980 Act which would allow the Society to become an ABS regulator

### **Consultation**

The Society's consultation paper on the regulatory scheme for LPs was published on 12 February 2010. It was distributed to members in the February e-bulletin and widely publicised. Comments were invited by 16 April 2010 and that deadline was extended by one week to 23 April to allow for any further feedback from the ABS referendum and the SGM. The consultation paper asked 14 questions on specific areas of the possible regulatory scheme for LPs.

In total, 27 responses were received by email and letter. Most were from individual members with five responses on behalf of organisations. Six identical responses from individuals were received. Some responses did not deal specifically with the issues raised in the consultation paper but expressed views on the concept of ABSs.

The Society held six ABS roadshows in Aberdeen, Dumfries, Dundee, Edinburgh, Glasgow and Inverness which were attended by nearly 700 members. The attendees were from nearly 400 organisations and 340 practice firms (representing about 25% of practice firms in Scotland). Some 70 questions were raised at these events and around 50 comments and questions raised in feedback.

We are grateful for the extensive engagement from members both formally through the consultation exercise and from the roadshows and other faculty visits. A number of concerns have been raised and the Society's team will continue to work with the government to address those concerns and bring forward amendments to the Bill.

The Council has also approved the publication of a report which collates all the responses received to the consultation paper, issues and questions raised at the roadshows or in feedback afterwards. These are reported anonymously.

## **Likely future timetable**

The Justice Committee has confirmed that Stage 2 of the Bill is likely to be in May and June of this year and that Stage 3 will therefore not take place until September

## **Update on principles of the Regulatory Scheme**

There are a number of areas where, as acknowledged in the Stage 1 debate, further work is required. These include any limits on the ownership of LPs, "fit and proper" tests for external owners, an equivalent for a Guarantee Fund for LPs, clarification over privilege and confidentiality and controls on the use of the descriptor "solicitors".

There are other areas where I thought it would be useful for you to know what our current thinking is. I also hope it reassures you that the scheme is being developed with appropriate safeguards.

- **Regulatory Scheme**

The regulatory scheme for LPs will be based in part upon the existing Practice Rules and Guidelines and in part on the specific requirements of the Bill. The scheme will need to be part of any application by the Society to become a regulator. There may be some changes required by Scottish ministers as part of this process. This scheme will include:

- Licensing Rules – which relate to the application process and the issuing or renewal of licences.
- Practice Rules - which govern how LPs operate.
- Other specifics including how regulatory conflicts can be resolved.

- **Legal structure of LPs**

As part of the scheme the Society will require LPs to be corporate entities or partnerships and to take the form of:

- Partnerships. This might include Limited Partnerships with limited and general partners to differentiate between passive investment and active involvement in the business.
- Limited Liability Partnerships (LLPs)
- Limited companies.

Corporate structures would not necessarily have to be Scottish registered entities. Shares could be held by corporate bodies as long as the ultimate owners can be determined.

Approving permissible structures is necessary so that ownership can be clearly identified.

- **The Society as a Regulator**

In the ABS referendum a decisive 81% of votes were in favour of the Society applying to be a regulator of ABSs if they are introduced.

The feedback from the consultation was that the majority of respondents would prefer that the Society to be involved in the regulation of entities providing legal services in Scotland.

- **Master Policy**

There has been no fundamental disagreement to the proposal in the consultation that LPs regulated by the Society should have to join the Master Policy.

There is concern that, to ensure that the Master Policy is only exposed to risk on activities that are “customarily carried out by a Scottish solicitor”, this will mean that these activities will need a more formal definition.

- **Annual Performance Report (APR)**

The Bill requires all LPs to deliver an Annual Performance Report to their regulator. The main requirements set out in the Bill are to report on:

- the LP's compliance with the regulatory objectives, professional principles and its approved regulator's regulatory scheme and any terms and conditions of its licence
- the involvement of any outside investors in the LP.

This report is the responsibility of the Head of Practice

It has been suggested that the Society should look at capital adequacy of an LP. Further work is required here and may involve pulling in the requirements of the Accounts Certificates in the APR.

Some responses have indicated that they do not want the APR to be applied to traditional firms whereas others have indicated that having a single system would be more efficient. The Society will continue to look at applying necessary regulation in an effective and efficient manner.

- **Roles of Head of Legal Services and Head of Practice/Member of Practice Committee**

Any holder of these key roles would be required by the Society to be a partner, member or director of the LP.

#### **Head of Legal Services**

We are likely to insist on requirements similar to those at present for principals. So the Head of Legal Services will need to have held an unrestricted practising certificate for three years and been on the Practice Management Course, subject to any waiver that Council may give in any specific case. This would ensure that someone of a suitable professional calibre holds this post in any LP.

Other thoughts include targeted CPD requirements, fixed term appointments and need for the regulator to be informed of the reason for the removal of any Head of Legal Services.

The Society is considering whether there should be a limit on the number of non-solicitors that can be supervised by individual solicitors

#### **Head of Practice/Members of Practice Committee**

The Society will not insist that this role is carried out by a solicitor but may limit it to members of professional bodies where memoranda of understanding exist with the Society in connection with the regulation of MDPs. They will have to pass the "fit and proper" test that is applied to solicitors. However the requirements for this role are likely to require appropriate management experience.

- **Equivalent roles to those currently required such as Client Relationship Partner, Designated Cash Room Partner**

These will form part of the regulatory scheme. Our current thinking is that the Society will require that the role of Client Relation Partner is covered by the

Head of Legal Services, who must be a solicitor. For the Cash Room Partner we may look to Head of Practice or allow, for example, the Finance Director to carry out this role.

The role of the Money Laundering Reporting Officer is required under separate legislation.

- **Fees for LPs**

LPs would pay for any extra costs involved in regulating them and in preparing the regulatory scheme. At present the number of LPs who might come forward to be licensed by the Society is unknown.

The government's Financial Memorandum that was presented as part of the Bill assumed that there would be some 200 LP applicants. The estimated set up costs of £100,000 (although this figure does not seem to cover the costs of preparing the Regulatory Scheme) would be recovered by the initial licensing fee. The annual running costs of £103,000 to £173,000 would be recovered through an annual regulatory fee of between £515 and £865. In addition no account is taken of possible differing sizes or complexity of possible LPs and flat fees as proposed may not be appropriate.

The Justice Committee's report at Stage 1 of the Bill invites the Scottish Government to reconsider the figures used and to provide clearer justification for the assumptions made in arriving at the illustrative costs.

The suggestion that the costs of the financial compliance inspections should be funded by Practising Certificates rather than Guarantee Fund levies will be considered over the next few months.

The Society is seeking amendments to the 1980 Act to allow it to change its basis of fees to charge at entity and individual solicitor level rather than just at individual solicitor level.

The development of the regulatory scheme will continue in parallel with the Bill as it moves through its various parliamentary stages.

The work on the financial and regulatory model requires detailed consideration of complex issues. This update may answer and also raise some questions so please continue to contact the ABS working group at the Society or your local Council member. This work is vital and your input will help us to shape a scheme which will work for members and their clients.

Yours faithfully

A handwritten signature in black ink, appearing to be 'I. Smart', written over a horizontal line. The signature is stylized and somewhat cursive.

Ian Smart

President

Please email any further comments to:

[absconsultation@lawscot.org.uk](mailto:absconsultation@lawscot.org.uk)

Alternatively comments can be sent to:

ABS Consultation  
The Law Society of Scotland  
26 Drumsheugh Gardens  
Edinburgh EH3 7YR  
Legal post: LP1- EDINBURGH 1