

Centre for Parliamentary Studies Regulation Conference 2009: Future of Regulation and Roles of Regulators

Plenary session: Managing the Total Regulatory Burden and Raising Standards in Regulation in the 21st Century, 11.55am-13.15pm, Thursday 2 July

Introduction

I want to use my remarks today to talk about the new structure for regulating the legal professions and the legal services industry in the UK and to explore whether it potentially offers any lessons for other sector. As will become clear, it is a strange – in some ways almost paradoxical – structure, but one which may, if it works, turn out to offer a new way for steering between self-regulation at one extreme and monolithic regulatory structures at the other. One might even call it “a third way” to steal an old phrase, which may yet be relevant in current market circumstances.

I offer it for discussion in the firm belief that regulators ought to be absolutely shameless in stealing ideas from each other – across sectors and across countries – which is why I welcome the chance to meet delegates here today. And I also welcome the fact that I am sharing the platform with Andrew Miller and Phillip Cullum, as Andrew’s Select Committee and Consumer Focus, are two of the very few institutions able to take an overview in helping ensuring that regulators don’t get stuck in their silos.

Brief history of legal services regulation

Let me begin with a potted – and caricatured – history of the last decade of legal services regulation in the UK.

At the turn of the millennium, there was broad agreement that the structure was broke and needed fixing.

Self-regulation by professional bodies no longer convinced. The lack of lay involvement was seen as enabling restrictive practices to go unchallenged, there was no obvious focus for consumer interest issues and complaints against solicitors, for a variety of reasons, were being handled extremely slowly. And the public were increasingly confused about how bodies such as the Law Society could, on the one hand, claim to be passionate advocates for the profession and defenders of individual members, while also being a dispassionate regulator.

And the process looked old-fashioned. The focus was on regulating individual professionals, not firms – enforcing an ethical rulebook, not finding commercial and reputational incentives for ethical behaviour, tackling individual misdemeanour, rather than looking at systemic issues or seeking to identify and eliminate risks to stop such systemic threats happening. Was that right for a £23bn industry.

Against that background, Government asked Sir David Clementi to review the regulation of the legal services market. His report included a spectacular wiring diagram of what he called “the regulatory

maze". It was the kind of wiring diagram to give an electrical engineer apoplexy, exactly the kind of diagram that, in financial services led to the demise of the SIB and its associated bodies and in communications to the creation of Ofcom.

But not here. Government oddly decided to simply the regulatory maze by adding a new body without subtracting any. What was going on?

There was no immediate appetite for a single FSA-style super-regulator . The law was – rightly – in my view seen as different in kind to many other markets because of its unique balance of citizen and consumer issues. It may be that the issue will return to the agenda if the current experiment doesn't work – that is perhaps a reason for all concerned to do their utmost to implement both the letter and the spirit of the reforms.

The alternative framework creates the Legal Services Board, with a staff of around 35 and a budget of around £4.5m. We have a lay chairman and a Board with a lay majority, but with skilled professionals on it as well. We oversee eight Approved Regulators, who have the responsibility for day-to-day regulation of individual lawyers and legal firms.

But we oversee them on the basis of shared statutory objectives - including protecting consumers, enhancing access to justice and the rule of law, boosting competition and promoting professional principles. We're also bound by the same better regulation principles which are enshrined in our founding Act, the Legal Services Act 2007.

The LSB has an important leadership role – particularly in providing direction and coherence to regulation of sector and making sure interests of consumers are put centre stage. We are establishing a Consumer Panel which will inform and challenge us on performance in delivering benefits to consumers. I expect them to keep the Board and the Approved Regulators up to mark in this area.

Because we have shared objectives, we expect to often agree with approved regulators on the nature of the action needed. But the Act also gives us very strong intervention powers in relation to directions, fines and withdrawal of Approved regulator status. Where we judge the need for action to remove risks and to ensure delivery of the objectives serious enough, we will not hesitate to use those powers.

Priorities

We have three immediate priorities.

- First, the creation of the Office for Legal Complaints to ensure more rapid and more effective dispute resolution through its new Ombudsman schemes;
- Second, more credible and independent regulation that constantly seeks to improve and renew itself – we'll make sure that the profession's regulation is demonstrably independent of all representative pressures on strategy and individual decisions and that regulators are regularly reviewed to learn lessons from each other – and elsewhere
- Finally, more choice and opportunities for lawyers and consumers alike by opening the market to new and more innovative ways of funding business, organising firms and responding to consumer needs.

In all these areas – and our other areas of concern, such as the development of a strong, independent and diverse legal workforce - we want to shift the focus of legal regulation away from detailed prescriptive rules and towards outcomes. There's a growing consensus in regulation about importance of effective implementation. The reform programme in legal services gives an opportunity for there to be a step change.

Response to Recession

But is this still relevant in a recessionary world ? The climate, post financial crisis, has changed from hostility to regulation towards a much more interventionist mindset generally. We need to be careful that the pendulum doesn't swing too far. It would be as foolish to assume that regulation of every sector has to follow the banking sector slavishly as to assume that there are no lessons to be learned. So I look forward to the outcome of the work of Andrew Miller's Select Committee's investigation, which looks set to do some judicious sifting of the lessons.

The key is to make sure that we know what "proportionate" means. It doesn't mean "a little on everything across the board". Sometimes it means "Do nothing – at all". Sometimes it means "Come down like the proverbial ton of bricks". The need for clear principles, excellent risk assessment and rapid proportionate intervention are reinforced, not removed, by current market conditions.

I also don't believe that recession is a reason to delay liberalisation. Indeed it highlights the urgency of opening up new options for capital, management and service delivery. The need for innovation in a recession is greater than ever if the future of the industry and public access to justice – in conditions when it may be more vital for more people than ever.

Is oversight regulation a new paradigm?

What are the elements of this model which may offer more general lessons ?

First, the fact that this is a holistic regulator which brings together a wide range of regulatory, citizen and consumer issues – access, competition, redress, consumer protection, mix of private and public funding – but without the scale of the mega-regulators.

Second, it potentially offers more constructive challenge to regulators' performance than central Government departments can provide because it is far closer to market - It's responding to wide change in the market structure and conduct, regulation, technology, customer expectations, public/private funding sources, which are shaping the legal services world quite as much as regulation itself. Because of this closeness and its demonstrable independence of political fads, it can focus more effectively on outcomes than a body at a greater remove from the market ever could.

Third, it is in a position to have "the best of both worlds". It can simultaneously enables and challenges both "expert" and "self-regulation" – the combination of both professional roles and economic ones, of wider citizen interest and specific consumer ones, of market structure and individual behaviour means that it can draw on the widest range of expertise – not least in the Approved Regulators themselves who are pursuing the same objectives.

What will make this model work?

It is too early to give a definitive answer, but here are some pointers.

- First, clarity and alignment of objectives and processes between the oversight regulator and those it oversees. The less alignment, the more complex the interaction and the greater the cost;
- Second, high quality staff, both Board members and executive;
- Third, as I've already said, a wide regulatory toolkit with ability and the willingness to use if necessary to prevent any game –playing
- Fourth, strong delegation of action to the appropriate level of the approved regulator or individual entity. The oversight regulator must, at all costs, resist “mission creep” except in areas of manifest regulatory failure
- Fifth, an important point. The oversight regulator must itself be accountable. But its own impact should be assessed on how its action affects “end user” firms, not the Approved Regulators – a burden on regulators may lessen the regulatory burden overall;
- Sixth, a proper balance of challenge and respect for independence from central government and clear reporting lines to Select Committees as well as Ministers – my Chairman and I have already given evidence to Sir Alan Beith’s Justice Committee and expect to do so again before too long;
- Finally, a willingness to benchmark against and steal creatively from other sectors and countries.

The Legal Services Board is making good headway against these markers, but it is far too early to say that we will definitely succeed. But I will say that I think that we will repay study from the “students of regulation” at whom this conference was aimed, because, just maybe, there could be a third way of regulating, which, by injecting a small, expert new body into a market, helps to reduce and focus the level of regulation overall. Thank you.