



## What is new in the world of Legal regulation?

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**Caroline Wallace**

Strategy Director, Legal Services Board

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### What is new in the world of Legal regulation?

Many thanks for the opportunity to speak today about regulatory perspectives and risk.

It is often said that the world of law is conservative, rooted in the past and unchanging. My view is that this is a bit of myth. Change has always happened in the legal services sector.

In the 1750s the scrivener notary's moaned about the encroachment of attorneys and solicitors into conveyancing. In the 1980s solicitors were worried about the advent of licenced conveyancers. Barristers continue to express concerns about solicitor advocates. All of these things happened before the LSB – and while possibly they were a bit haphazard – they show that change is a constant.

However, without a doubt the Legal Services Act has sped up the pace of change. The LSB has enabled the following changes which have now been implemented by the frontline regulators:

- Allowing barristers to conduct litigation – a freedom nearly 130 barristers have taken up;
- allowing more barristers to provide services directly to the public – and one in five barristers intend to do so in the next two years;

- allowing firms regulated by the Institute of Chartered Accountants in England and Wales to provide probate and estate administration services;
- allowing non-lawyers to be owners and managers of SRA (and CLC) regulated entities; and
- We are in the process of allowing the necessary arrangements to permit legal executives form their own regulated firms providing litigation, conveyancing, probate services and advocacy.

The most column inches have been written about the alternative business structure (ABS) firms. Much of the coverage has focused on the unusual, the new entrants and the celebrity backers. A delicate sprinkling of schadenfreude covers any of their difficulties. But there have always been failures of legal firms – failure is nothing new. Traditional firms fail and so will ABS. What matters is that, when this happens, regulation protects consumers and the regulatory objectives.

Since the introduction of ABS there are at least ten listed firms that have an ABS licence or own a subsidiary with a licence. There are niche two partner firms with an ABS licence. There are local authorities with an ABS licence. There are household name firms bringing their in-house legal teams into the legal services market. There are charities and not for profits. Even country gentlemen have their own association that can provided regulated legal services.

But what also needs recognising is that the majority of the 350 ABS licence holders are evolutionary (not revolutionary) developments of traditional business models. They are regular law firms who wanted to recognise the contribution of non-lawyer staff by granting them equity, firms that wanted to explore joint venture opportunities with other firms or firms that simply wanted to attract capital without taking on more debt.

The introduction of ABS has also led to efforts by existing law firms to out-compete these new entrants. Thus it is not just new entrants, but the process of rivalry itself, which drives improvements for consumers. The LSB has observed the extension of fixed fees for consumers, the creation of national franchises for legal services and the use of new technologies. Firms are using new ways of communicating with consumers and using technology to create legal documents. This is extending the possibilities for access to justice. Some lawyers are even opening on a Saturday.

Regulation has not made this happen. Competition has, liberalisation has and innovation has. These changes have been made against a back cloth of significant challenges; whether

recession or reduction of legal aid. Not all of this change has happened within the regulated sector: we have also seen an extension of legal services provided outside regulation. This includes document assembly services, legal consultancy for the largest firms as well as McKenzie friends.

### **Why risk based regulation?**

It is not possible to regulate risk out of existence and you would be mad to try. Risk surrounds us in the choices we make and the actions of others. There are bad apples, poor outcomes and dissatisfaction in all areas of life.

However, clearly there are risks that we cannot stand by and do nothing about. For example, legal services risks which if left unchecked to crystallise would lead to significant harm to individuals, to market confidence, to competition and to wider public interests – even to the point of undermining confidence in the rule of law itself.

We also consider that risk based regulation enables regulators to target scarce resources at the biggest problems. Regulators do not have unlimited budgets and their costs are paid by practitioners and ultimately consumers. The legal services market is worth some £26 billion and employs nearly 350,000 people in England and Wales. The regulators in this market operate on under £100 million and have under a thousand employees between them. They must focus their resources on the areas that pose the greatest risks. Such a focus may involve tougher regulatory and supervisory obligations for those lawyers providing services to the most vulnerable in society or where the consequences of poor service provision are the most severe, and a different approach for those providing services to the biggest of companies.

Risk based regulation has also been the dominant approach in public policy across the world. It is recommended by the OECD and it is embedded in the better regulation principles in the Legal Services Act.

The legal services regulators have made great strides in adopting risk based regulation. For example, the BSB have risk assessed all of the chambers barristers operate from and are targeting their supervision at those which pose the greatest risk. IPReg, the regulator of patent and trade mark attorneys, has also embarked on a similar path.

I suppose the question practitioners may be asking is what does it mean to be regulated in a risk based way? And what will it mean for my day to day practice?

To regulate in a risk based way you need three main things: evidence, assessment of harms and intervention or control of those harms.

Compliance will not be a matter of ticking boxes. It will involve more collaboration between the regulator and the regulated.

Practitioners can expect their regulators to be more interested in how firms go about their business, the consumers they serve and the services they offer. This may lead to provision of more information to regulators or greater investment in research by regulators. You can also expect regulators to be curious about what leads to poor outcomes for consumers and the wider regulatory objectives. They will seek to identify the possible sources of harm and choose those which are the most important. Once done they will seek to intervene in a way that is targeted and aimed at unravelling the root cause of the harm. They will not necessarily seek to cure the symptoms but instead treat the cause.

This is by no means an easy endeavour. But we believe it is the approach most likely to deliver a well-functioning legal services sector which meets consumer needs and fosters choice, innovation, value-for-money and a strong, ethical and diverse legal profession.

### **Looking forward...**

I'd like to now spend a little time looking forward to what we at the LSB intend to focus on in the coming years. Next week we will launch a consultation on our new strategic plan for the period 2015-18 and what I say now draws heavily from it. In this context, I was very interested in Louise's point earlier this morning about the close link between strategy and risk appetite.

The LSB Chairman Sir Michael Pitt is on record acknowledging the importance of the legal sector to the economy. The reputation of our legal system contributes to making the UK an attractive place to do business, and brings inward investment and new jobs far beyond the boundaries of the sector itself.

In drawing up our strategic plan, we've taken into account:

- The rapid pace of change in the market compared to historic levels;
- Research results showing continued and significant unmet need for legal services;
- The Legal Services Consumer Panel's recent report about what future legal services may look like and how regulators should respond. Crucially, in its report, the Panel highlighted that the risk environment is likely to change – not that there would necessarily be more risk, but that risks would be different. These different risks would result from the increasing 'marketization' of services and the increased use of new technology to deliver services. The Panel has raised the possibility of 'digital detriment'. This is the idea that vulnerable consumers who can't access the Internet

may be left behind while those consumers who can use the Internet will face trading risks that may be familiar in other sectors but that will be relatively new to the legal sector.

Our strategic plan aims to respond to this changing environment. In it we are proposing to structure our work into three distinct but linked strands focusing on:

- firstly, **breaking down regulatory barriers to competition, growth and innovation.** We aim to ensure that unnecessary regulation which can stifle positive changes is removed, thereby delivering the benefits of competition, growth and innovation to consumers and lawyers alike
- secondly, **enabling need for legal services to be met more effectively.** Legal services must be affordable and accessible, consumers must be able to make informed choices to take advantage of the range of services that a more dynamic market will offer, and appropriate protections for consumers and the public interest must be secured, and
- thirdly, a **programme** of on-going activities including our statutory decisions, our work on maintaining regulatory standards and our over-arching research. This work keeps us in touch with the real-world challenges faced by the front-line regulators, lawyers themselves, and consumers.

I want to touch for a moment on the unregulated part of the legal services market.

The unregulated sector accounts for close to 30 percent of the turnover of the legal services market. This is a not insignificant chunk of the legal services sector.

In our work over the next three years, we intend to take into account the implications of some types of legal services being available from both regulated and unregulated providers of legal services. We will do this firstly because consumers make choices in a market in which unregulated providers already play a significant role and secondly, because we, and you, need to understand how regulated service providers can compete on a level playing field with unregulated service providers.

## **Change**

Today I have touched on the origins and benefits of risk-based regulation.

Over the next three years, our work will be carried out in the overall context of a market that is likely to continue to change both rapidly and dramatically.

How do we see the market changing?

We see the legal services market changing as new entrants, consolidation and the exit of those who cannot adapt steps up a pace.

We think that there is likely to be greater consolidation as providers seek to increase their competitiveness in a more crowded market place. Increased scale can drive increased cost effectiveness, as well as enabling investment in technology and providing customers with access to a wider portfolio of related services and expertise.

There are likely to be more providers exiting the market than in the past. This is an inevitable product of an increasingly competitive market place. Some new business models won't work. Some decisions to scale up will result in failure. Some providers that are reliant on a declining flow of legal aid work will be unable to find alternative income streams.

It is also probable that expansion of the regulated sector, including alternative business structures, will be at least matched - if not exceeded - by expansion of the unregulated sector where there are few barriers to entry and a lower (regulatory) cost base.

Services offered are likely to change as competition and new thinking drives innovation. For example, there are likely to be more legal and non-legal services provided under one roof, sometimes to the same individual as a package of broader professional services or business advice. There will also be more unbundling of services - with consumers and different providers combining their efforts to deal with different parts of the same case and more on-line services and greater use of technology.

We also think the increasing use of non-adversarial legal processes such as alternative dispute resolution; and the simplification and digitalisation of parts of the Court system and some state legal processes will see less need for and use of lawyers in certain areas.

There is likely to be increased focus on the international context, such as continued encouragement for the export of legal services and legal education and a continued growth in London as the premier centre for dispute resolution, and other jurisdictions developing their own liberalisation agendas, informed by the precedent set by our Legal Services Act.

## **Finish?**

To recap - today I have introduced the key themes from the LSB's new strategic plan which aim to respond to these changes. These themes are: breaking down regulatory barriers to competition, growth and innovation and enabling need for legal services to be met more effectively.

I look forward to hearing your comments after this and hope that you will find the time to contribute as we consult on our plan.

Then it is over to you as service providers to make the most of the new opportunities that these changes will bring.