

The Future of Legal Regulation



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Many thanks for inviting me along today to speak at this conference – my second year at this event. For those who have forgotten, or weren't here last time, the legal services board is the oversight regulator of legal services. We are tasked with ensuring the delivery of the regulatory objectives set out in the Legal Services Act 2007.

I was asked to talk today about the future of legal services regulation. I have no crystal ball and the government are carrying out a review, so the direction of reform could take an unexpected turn. Given this, I'll focus today on where the LSB believes the future lies...

But, perhaps first I might remind everyone how we got here and the extent to which we have tackled the problems that led to the last six years of regulatory shake-up. Then, perhaps I might speculate on where next. At present, as ever, the actual future remains uncertain.

Recently it was put to me, by a senior lawyer, that the reforms to legal services regulation were intended simply to allow a change of finance directors in law firms. In a purely technical sense this is at least in part true, the act led to

changes that allow non lawyers an ownership stake in law firms, but nonetheless such a view does not, I believe, fully reflect the ambition of the Act. The reviews from first the Office of Fair Trading then later from Sir David Clementi aimed to shake up the whole historical framework of legal services regulation. They recognised early that a modern competitive legal services market, supporting consumers and businesses was at the heart of a successful economy.

We stand today at a crossroads considering where to go next. It is essential that the choices made are informed by evidence and an understanding of the role that regulation plays in this market.

Slide 2: Regulation provides the rules for the market

What are the rules?



Legal Services Board 2

Let's start with some givens. Firstly, regulation provides the architecture in which a market works. Where-ever you see human activity you also see rules. What, I ask, would football be without rules or perhaps I should say, regulations. Football is a successful sport as the broad rules are fairly simple, spectators and players alike understand them – or rather while they haven't looked at them in detail, they are generally simple enough that detailed analysis of the rules is unnecessary. It's simple to make a game, you need some space, a ball, and I would suggest at a minimum a couple of jumpers.

When the games really matter we employ referees to ensure that the rules are obeyed. Over time regulation plays catch-up as technology changes, goal-line technology has for example only just been introduced.

Of course football also demonstrates the genuine difficulty of enforcing the detail of the rules. Supervision by a referee is at a ratio of 1:22; mistakes by referees who themselves don't know the absolute detail common; retrospective punishment frequent. Certainly, regulation is a challenge.

And before we return to law we should remind ourselves of what Bill Shankly once famously said:

"Some people believe football is a matter of life and death, I am very disappointed with that attitude. I can assure you it is much, much more important than that."

Whether regulation or rules are: tradition; statutory regulation; have oversight regulators; or are simply set by a professional body – self regulation – they impose the rules of the game by which a market plays. These 'rules of the game' in law are essential to ensure both the protection of consumers and that of the broader public interest - the effective rule of law is central to the operation of the market.

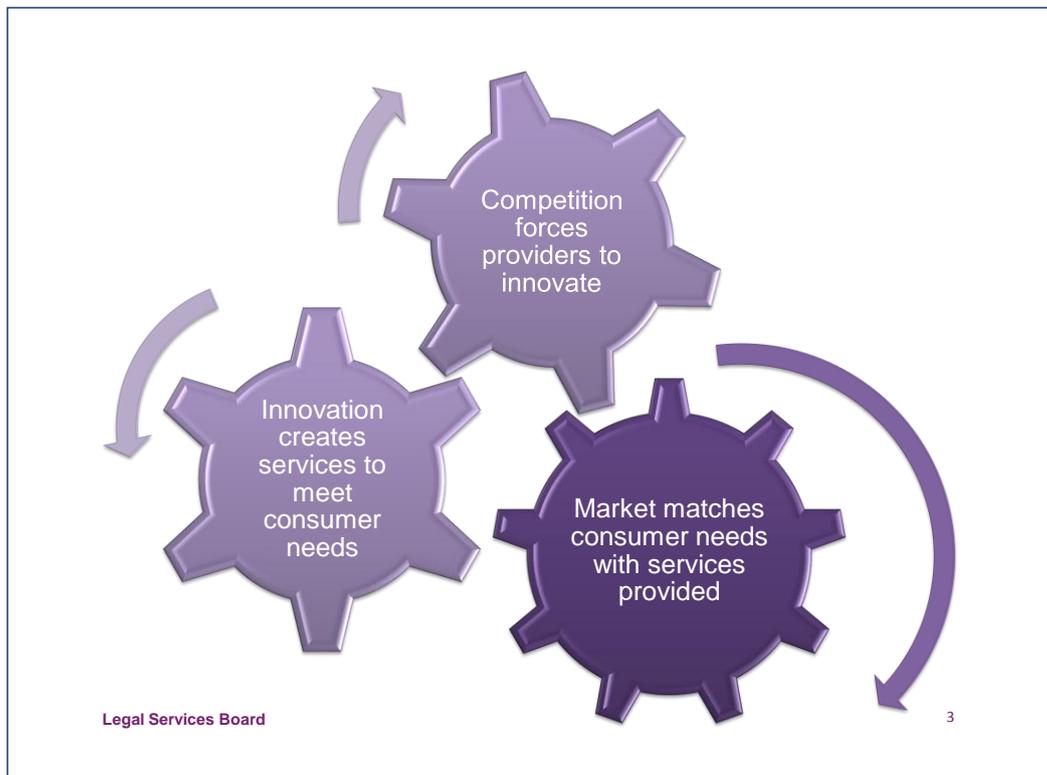
The 2007 Act sought to change the rules of the game for legal services, shake up the status quo, liberalise and open up the market to the benefit of consumers while maintaining the strengths of the existing market. So that leads me to the first basic point that I wanted to make:

Any liberalisation of regulation must not remove the basic protections needed by all consumers.

A second, related, point is that access to justice is central to civil society. Its absence or a perception of its absence can undermine the confidence we have in the rule of law and in turn the fundamental building blocks of our modern economy.

The rules we impose on the legal services market must recognise these facts and work within this framework. While the Act sought to liberalise, we should not forget that is itself 400 pages of detailed regulation!

Slide 3: Inside the framework



Beyond these truths we must recognise that the market is the most effective mechanism we have to match the needs of consumers with services provided. We do not have a centrally planned economy, even before the Act we did not have a centrally planned economy. The market and desire for profit has been around in legal services for a considerable period of time. We might argue that regulation and government intervention has in the past, and continues to have, a rather more influence on the working of the market in legal services than elsewhere in the economy, but at its heart legal services is a market.

So if we have regulation to protect consumers – the rules of the game – within this framework how do we ensure that consumers get the services they need? We cannot centrally plan what to provide so we let the market take the lead. It is simply not possible nor desirable for providers of vital services to rest on their laurels, consumers change – whether in their basic needs, expectations of services, or their use of technology, time etc. etc.

As consumers change firms seek to understand consumer needs and change their services or offer entirely new services to attract consumers; they innovate. Innovation in legal services takes many forms, from online services – whether whole services or case tracking software – to new pricing models. Not every consumer will want these innovations, a diverse market offers choice, people find the services suited to their needs. Hence consumers need good feely available information, whether from professional bodies or other trusted sources. But without innovation consumers are left with a simple choice... like it, or lump it.

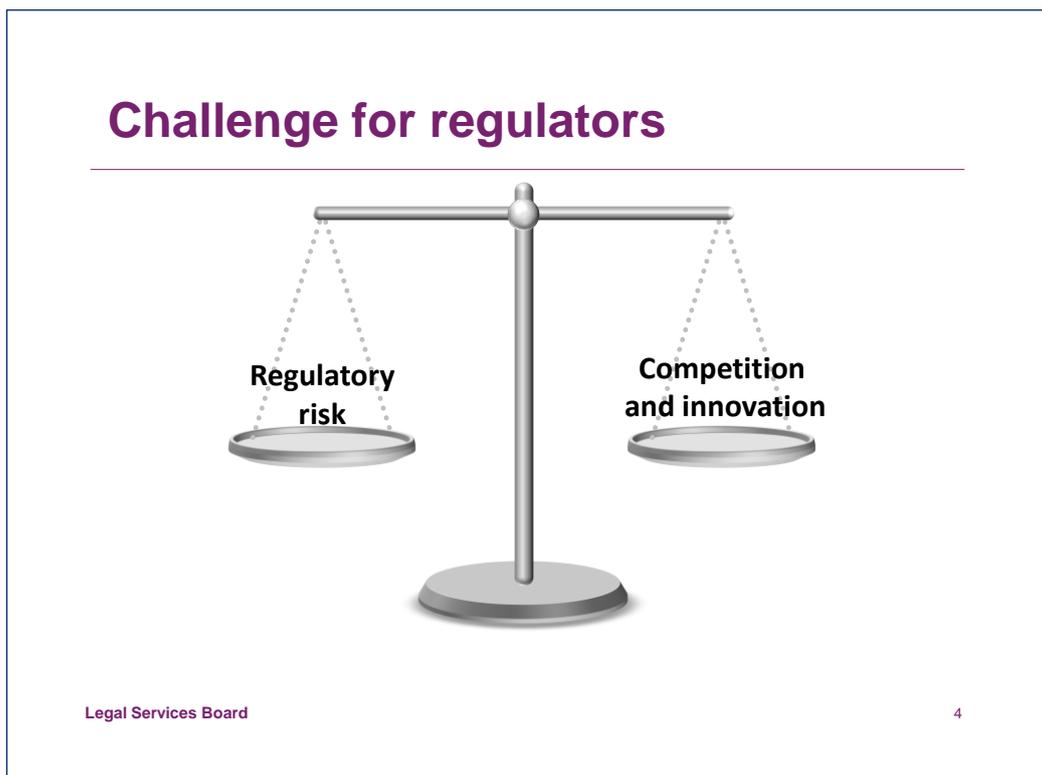
Regulators must be alive to the risks that innovation brings. Inevitably some innovations won't work, some will seek to take advantage of superior information to offer consumers choices that aren't in their interests. That remember is why regulators set the 'rules of the game'. Increasing flexibility in the market requires regulators to up their game in spotting bad practice and acting to stop it.

So if we believe that innovation brings benefits to consumers what are the features of the market that drive more innovation? The obvious conclusion here is that it is competition is the force that drives firms to innovate. Competitive pressure on firms to find customers and offer services they want occurs when firms seek to maintain or grow their profitability. Again, this is not a new feature of the market post Act. Legal firms have always tried to make profits. It's the way that anyone running a business seeks to pay the mortgage.

So I would conclude from this that effective competition must exist within the regulatory framework and innovation must be encouraged if we want the legal sector to be able to continuously change and adapt to meet the changing needs of customers. The regulatory objectives require us to put ideals such as access to justice, consumer and public needs at the heart of our approach to regulation. These needs, I would argue, will only be met in a liberalised competitive market supported by a well evidenced regulatory framework.

It is because of this that I believe that we too often, too lightly, dismiss the role and need for competition in legal services.

Slide 4: Challenge for regulators



The challenge the LSB are keen to bring to regulation is that regulation shouldn't protect legal firms from innovators. The challenge for regulators is how to provide this essential regulation while allowing new, unfamiliar approaches which have the potential to open the market to more consumers. Get this wrong and we risk ending up with some combination of homogenous services, high prices, poor access, consumer money stolen, consumers ripped off or even a lack of public confidence in the institutions of law.

Regulators must be brave, they have to accept some degree of risk that some decisions they take will lead to negative headlines. What is the alternative? That we take a much bigger, but less visible risk that value for money from legal services is poor, innovation prevented, access denied. These are also risks that impact on our regulatory objectives, they're just easier to take as they are risks that something that might've happened, doesn't.

I don't suggest that regulators forget their primary duty to regulate, far from it – the length of the Act reminds us that this is a heavily regulated market and one that parliament believes should be heavily regulated. I do suggest that regulators need to think more carefully about the unseen impact they are having on the development of the market.

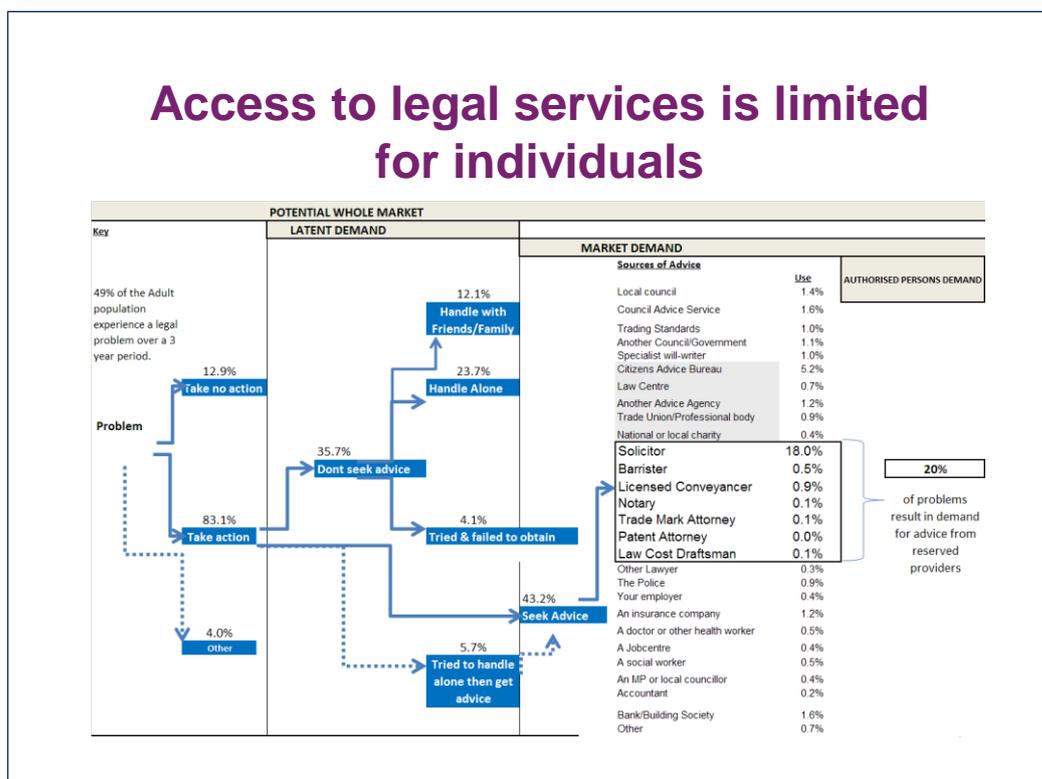
I would suggest another key lesson from the past six years is that the market, not regulation, is the principle driver of changes in legal services. Regulation, if anything, is simply playing catch-up. Alternative Business Structures (ABS) already existed before the act. They simply existed as unregulated firms providing non-reserved legal services and among providers like trade mark and patent attorneys or costs lawyers, where ABS were simply not banned and not required to be authorised pre the Legal Services Act 2007.

Regulators must resist the notion that they can turn back the clock or micro manage every relationship between firms and their clients to control risks. Instead they must be clear about the limits of their capability and tailor regulation at realistic aims. Regulators have a variety of tools including before the event protection; ongoing monitoring or after the event compensation. Different tools have different levels of effectiveness. Too often in the past reliance has been placed solely on before the event protection with the effect of creating barriers to competition with little demonstrable benefit for quality.

The conveyancing profession was introduced as competition for the solicitor monopoly because it was realised that specialised providers of legal services could play an important role in the market helping consumers access affordable legal services. This demonstrated the potential of looking again at the way in which legal services were offered and the barriers that regulation imposes on market flexibility. Time is perhaps ripe for the legal services regulators to think again about how they might further increase flexibility.

In June this year when the Ministry of Justice published their call for evidence looking for views on the future structure of legal services regulation, they asked for ideas for reducing regulatory burdens and simplifying the legal services regulatory framework. For the rest of my slides I will turn to our response to this review and the evidence that points to how we frame the challenge.

Slide 5: Access to legal services is limited for consumers



In their submission to the Ministry of Justice, the Law Society and Bar Council both made the case for returning much of the regulatory structure to the professional bodies in an attempt to simply cut the cost of regulation. Remove the regulators, remove the cost. This of course misses a key point. Whether regulation is done by The Law Society, Bar Council, Solicitors Regulation Authority or the Bar Standards Board or even a single legal services regulator, what matters is not who regulates but how they regulate. The problem is that self regulation (perhaps more aptly known as professional regulation) inevitably introduces more regulation not less and makes greater attempts to restrict competition. Which, as I outlined earlier, damages the very objectives we strive to achieve.

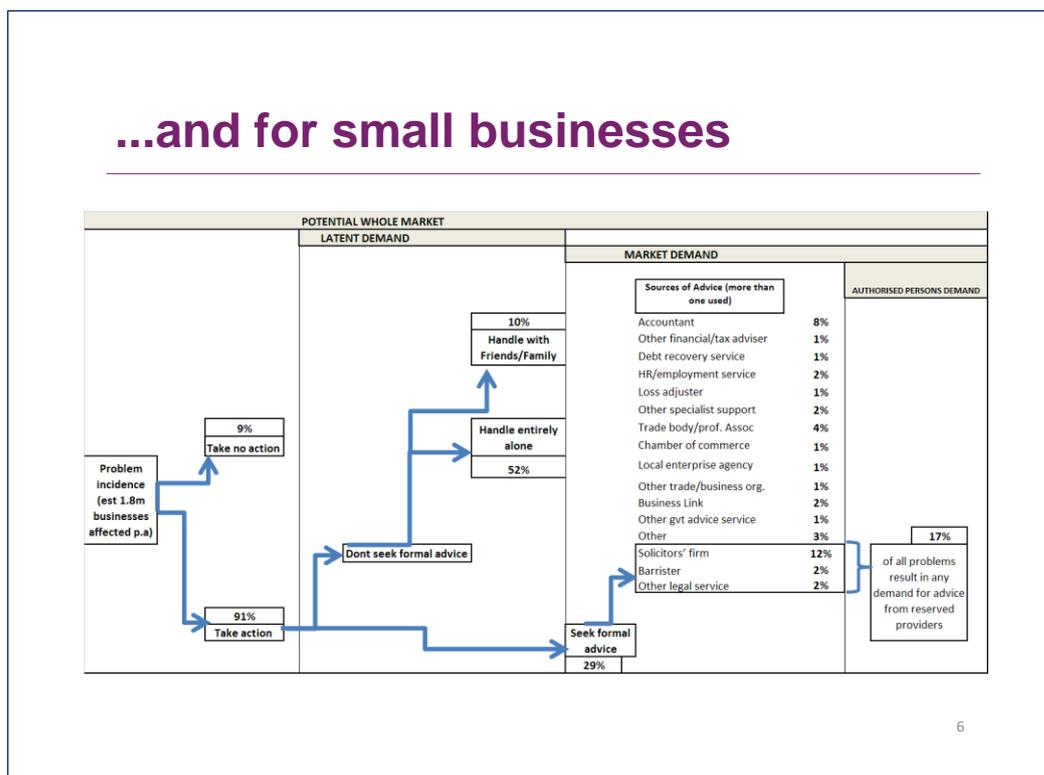
The legacy of self-regulation still lives with us today. This is a legacy of high barriers to entry (e.g. prescriptive training rules centred on learning rather than outcomes); restrictions on innovation (e.g. the separate business rule); and prescriptive rules which create a compliance culture (e.g. client account rules). This same self-regulation gave us bans on advertising, controls on firm names, restrictions on forms of funding for firms and many other restrictive practices that did little beyond protecting the lawyer from competitive forces. Furthermore, despite all this intervention, under the watch of self-regulation

we have seen significant lawyer involvement in mortgage fraud, scandals such as miners' compensation and appalling handling of consumer complaints.

Let's not forget that the legal services market today still fails to deliver affordable services in the way that individuals and small businesses want. Our consumer research (shown on this slide) found that 1 in 3 individuals don't get the help they need. 12.9% take no action at all, 1 in 25 try, but fail to find advice that meets their needs. Using regulated legal providers is in practice for the minority of legal problems only.

Professional bodies play an important role in society, but parliament concluded that the evidence from several hundred years of legal services, was that regulation was best done independently from those being regulated.

Slide 6: Small businesses access is if anything, worse

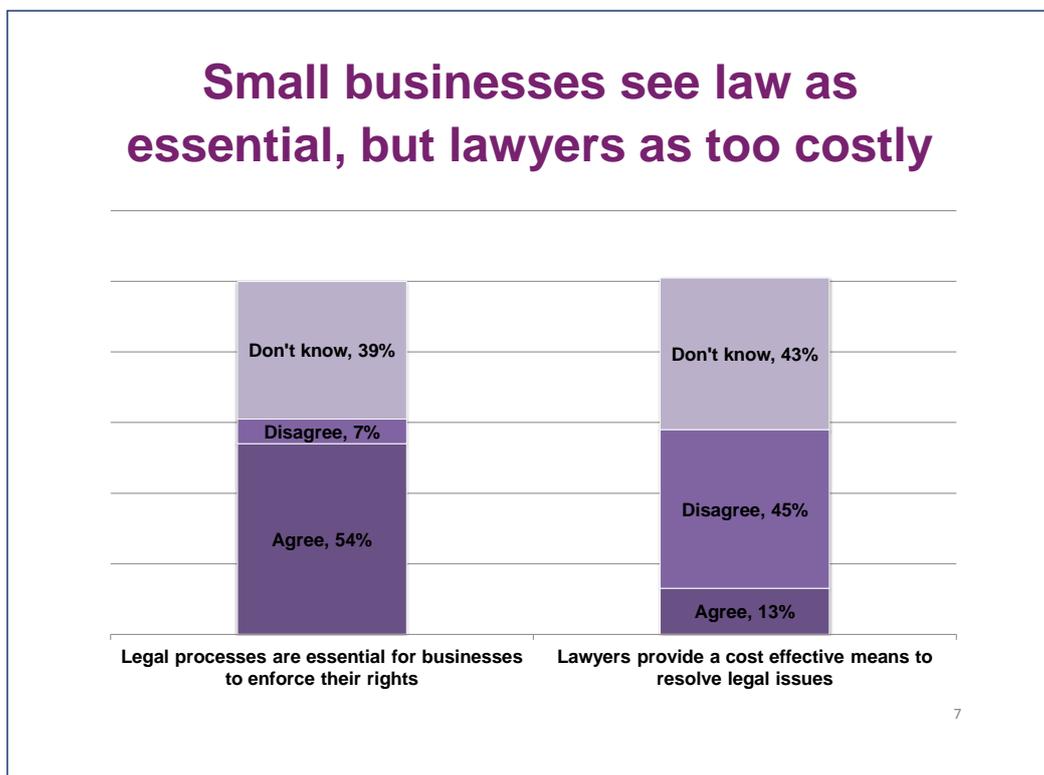


For government with their concerns about economic growth and the deficit, the problems facing small businesses getting legal advice are even more concerning. Less than 1 in 5 small businesses get legal advice when they have a problem.

Clearly we have to be careful interpreting these figures. No one (I think) imagines that in every circumstance where a business has a problem which could have a legal solution, would the legal solution always be the best way to solve the problem. Many disputes are effectively and cheaply solved with a chat over a cup of tea. But in many cases a cup of tea isn't the ideal answer.

The median value of the financial impact of the legal problems for small businesses in our research was £1,200, scaled up to the UK that's £100 billion cost from legal issues for small firms. While many legal problems are dealt with effectively this is clearly a massive market. Some might say an opportunity for an innovative legal firm.

Slide 7: Legal services essential, but too costly



I use small businesses here as an example as we have a good data set. When we look at this segment we see the conundrum facing people with legal problems: 54% see law as very important for doing business yet only 13% SMEs see lawyers as value for money.

People value good legal services, they want help from lawyers. Could legal services be delivered in different, more efficient ways? I suggest yes. I also

suggest that regulation, more importantly excess regulation may be one of the factors that inhibits the market from delivering low cost innovative services.

Slide 8: LSB so far

LSB so far...

Improving regulation

- ensuring independent regulation
- changing focus from rules to outcomes
- reforms to regulators' role in legal education

Making the market work

- introducing ABS
- Ombudsman and improved complaints handling

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Through the introduction of independent regulation we have started to challenge the legacy of professional self-regulation seeking ways to reduce unnecessary regulatory burdens and set businesses free to deliver legal services for people that need these vital services.

The Legal Services Board is driving the liberalisation of regulation necessary for innovative firms looking to meet the needs of customers where historically professional bodies have designed regulation to avoid risk and protect the profession. Our objective is not unfettered free markets. That would have been a much simpler Act and would not have required either the LSB or the front line regulators. We want less restrictive practices and more effective consumer protection.

Our work so far has both sought to improve existing regulation and to improve the market itself to deliver better outcomes to consumers. The LSB, to be clear, do not directly control the regulation of legal services. We work with the frontline regulators, giving formal guidance where necessary, challenging and

sometimes directing. I've picked up a few examples of areas of our work in the slide, these I believe are key changes that have the potential to significantly free up legal businesses to innovate and serve customers better.

As one example, outcomes focused regulation requires those being regulated to move outside of their comfort zone. But in return, for those willing to embrace it, it offers the opportunity for much greater flexibility in meeting their regulatory requirements.

Likewise, following the publication of the Legal Education and Training Review, commissioned by the SRA, BSB and IPS, we are encouraging all legal regulators to reconsider their approach to the regulation of legal education. What skills are actually required, before the event, to practise? The language of learning outcomes and day 1 competencies should become more familiar. They act as a challenge to all regulators, not just those commissioning the LETR, to consider whether the requirements they place on people to offer legal services are based on an actual assessment of risk.

Conveyancers were, as I'm sure you know, first to launch an ABS firm. This new form of legal business is not a panacea to problems in access to justice, simply an important part of a liberalised legal services market that recognises the skills that a wider pool of talent can bring to legal services.

To summarise, so far, our work has led to: over 200 ABS firms in the market, with hundreds more in the pipeline; a review of regulation and training with plans now to significantly increase the flexibility for future lawyers and the promise of real flexibility for firms to make their own decisions about their workforce's education and training; major steps towards entity and risk based regulation reducing burdens on low risk businesses; and the introduction of a credible complaints system. We believe that there is much more to do.

Slide 9: MoJ call for evidence

MoJ call for evidence

We conclude that:

- *existing legal services regulation is failing to meet the principles of good regulation*
- *introducing full independence of regulators from the profession is essential to delivering effective risk based regulation that minimises regulatory burdens, and to providing better incentives for truly excellent professional practice*
- *a tighter focus on risk among legal services regulators is both achievable and would lower regulatory burdens for many firms and practitioners*
- *immediate simple legislative changes could produce further quick reductions in regulatory burdens*
- *a simplified regulatory structure could be developed that would further reduce regulatory burdens.*

Legal Services Board *A blueprint for reforming legal services regulation* (London, 2013)

In our response to the Ministry of Justice we made it clear that in our view regulators can go further in seeking to balance their desire to protect consumers and the wider regulatory objectives while at the same time allowing the market to thrive. Too often regulators have looked at risk and thought the best approach was to address it with layers of regulation that often did little more than protect the profession from outsiders.

In the short term actions can be taken to simplify the legislative framework which would allow immediate further simplification of legal services regulation. Inevitably, I would suggest, those professions with a longer historical presence have built up a heavier weight of regulation that might need reconsidering within such an analysis.

We will place further pressure on regulators to simplify regulation, target risks and remove disproportionate or ineffective rules. The Better Regulation Principles of proportionality, accountability, consistency, transparency and targeting are well established. At their heart they speak of regulators that understand the risks that are presented in the market they regulate. Regulators who understand the tools that they have, and further, understand the limits of their effectiveness.

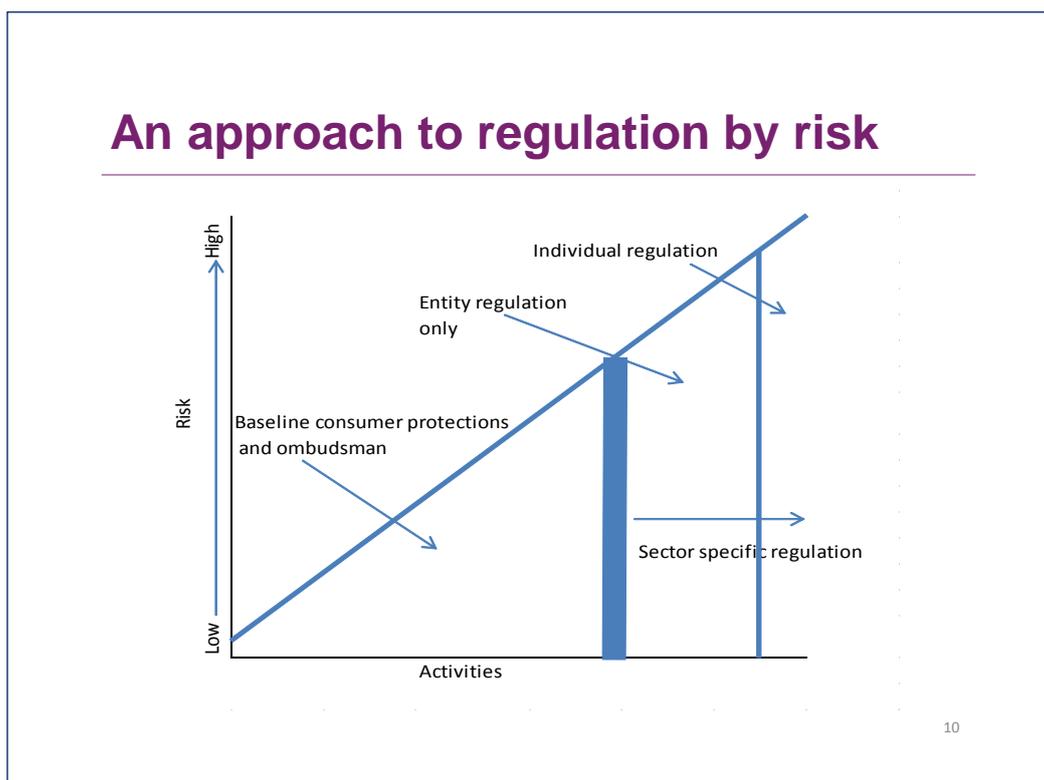
A significant concern for us is that, as background consumer law has progressed, regulators have not considered what the changes mean for the protections they have in place. In which areas has the rising tide of consumer law replaced the need for sector specific regulation? This matters as regulation places burdens on firms, this stifles innovation, it increases the costs to consumers, it leaves people unable to get the legal advice they need.

We have made it clear that we would like to see the current model of independence go further. As we see here today, conveyancing regulation is entirely independent of their professional body. We would like to see this independence given to all of the legal services regulators. Professional bodies must be the champions of the culture and history of their profession. The titles are great brands for consumers, brands that allow consumers to choose legal services with confidence. They also act as powerful brands for those offering services, highlighting common ethics, shared approaches and beliefs that reinforce good behaviour. Regulation must focus on risk and the regulatory objectives. This is more likely to happen where regulators are fully independent of their professional body.

We also floated the idea in our 'blueprint' of seeking an independent review to develop a long term regulatory model that removes the layers of regulators and allows a long term focus on effective risk based regulation. We wondered aloud whether this model would be a single legal services regulator –for the record not based on the LSB or indeed any of the existing regulators.

Such a change could involve significant short term costs; it might have many other drawbacks. Even if there isn't a single regulator, does there need to be a separate conveyancing regulator or could authorisation fall to other regulators, such as the SRA or IPS? We certainly haven't done an assessment to show that any of these ideas are inevitably the right solution, hence why we call for a review to consider the structure of regulation. But, if we want to develop a long term regulatory model that significantly strips away regulation, restructuring of the regulators may be an idea whose time has come.

Slide 10: An approach to risk



I wanted to finally, briefly, turn to an example of what regulation might look like in the future. In particular an approach that could put risk at the heart of how we regulate.

Currently regulation of legal services in England and Wales is centred on the reserved activities, six narrowly defined activities that bring the provider within the scope of legal services regulation. Provide any other legal services and, unless you also want to provide reserved services, you're free from regulation. Once you're in, you're commonly regulated for everything, in effect a cliff-edge approach to regulation decided independently from any consideration of the purpose of regulation or understanding of risk.

What might happen if instead of seeking to regulate by historical precedent we sought to fully integrate regulation with basic legal protections available for everyone? Reconsidered whether more intrusive sector specific legal services requirements were really necessary? What might regulation look like? For a start regulators might look at a much wider set of legal activities that may require to, at least, be within their sights.

While I would suggest that more might be within the widest scope of regulators, in practice many legal services, as now, would require little in the way of day-to-day intervention. Instead, in the majority of cases a mixture of existing legal protections, a basic code of ethics and the right of access to an ombudsman would be sufficient.

At a certain level of risk, and it is for government to decide how much risk is acceptable as shown in the recent case of our will-writing recommendation, sector specific regulation above basic legal protections will be required. Initially I would expect that regulators would look at how entities manage the risk, how they train their staff, what systems they use to manage their risks.

Only for a minority of activities would individual regulation be required. And by individual regulation I, of course, mean the requirement to hold specific qualifications, be an approved person for the activity etc.

This isn't fiction. Already for some high risk activities (often currently sketchily defined) regulators are adopting entity based regulation, the LETR shifts responsibility for skills to day 1 competencies, CPD is becoming more responsive to actual needs rather than time served, the Quality Assurance Scheme for Advocates is seeking to put in place a much tougher individual regulatory regime.

Regulators have started to grasp the nettle of a tighter focus on risk based regulation. Thus allowing the market greater opportunity to flourish inside the framework of regulatory rules of the game.

Slide 11: To conclude with questions...

To conclude with questions...

- What are the risks in conveyancing that regulation must tackle?
- What is the right balance between before the event protection, ongoing supervision and after the event intervention?
- Do multiple profession specific regulators make sense? What might change the assessment?
- Are regulators doing enough to remove unnecessary, poorly targeted regulation?

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Regulators are not the architects of change. Change is being driven by consumer needs with forward thinking legal businesses responding to the market and meeting needs. Regulators must strive to understand and mitigate risks but, where possible, allow the market to find the right responses.

There are many challenges for regulators, not least for regulators of conveyancing. We all must together challenge the regulators to grasp the necessity for change, whether you offer services, run professional bodies, or apply oversight to regulation, ensuring that the regulation we have is fit for purpose. We have an opportunity to reduce the burden that regulation places on legal services while maintaining our focus on the regulatory objectives.

Continued efforts to remove unnecessary regulation have the potential to reduce burdens on firms, increase access to justice and improve public confidence in the rule of law. I hope in the coming years we realise this opportunity.

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