



Innovation and legal services regulation

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Good morning. It is a pleasure to be with you today and to be able to share my first impressions on the regulation of legal services and the role it plays in supporting innovation in our sector. Since joining the Legal Services Board (LSB) in February 2015 I have been able to meet with many of you. For those of you I have not had the opportunity to meet, and who are interested in this subject, please grab me for a word at some point during the day.

Where I am coming from...

One of the things I've been able to do in my first few months is to look at legal services regulation with a fresh pair of eyes. I am not a lawyer by background, but I do come to this role with a strong conviction that the *rule of law* is a vital foundation for our civic society and our economy. It ranks alongside the freedom of speech as one of the cherished values in our unwritten constitution. Having worked closely with international infrastructure investors in a previous role, I can tell you first-hand how a lack of confidence in the surety of the rule in law in other countries has seriously held back opportunities for investment, economic growth and social development.

I also have a passion – not a word that comes easy to regulators – to make sure we do all we can to support *access to justice* and unmet legal need. I hope I bring a perspective on regulation based on my experience of how a number of other regulated sectors, where there are also vital

public interest objectives, have risen (or faltered) in the face of challenges posed by profound market, consumer, technological and government policy changes.

Avoiding a 'trilemma'

I am struck by the contrasts I find in the legal services sector. It continues to grow and contribute more each year to our economy and exports. We should be proud that our legal system is viewed as the gold standard across the world. But as our Lord Chancellor pointed out recently, not everyone benefits from this. And I have heard at first hand from my conversations with members of the public and members of the profession about unmet legal need and the present challenges in trying to address it.

Among my first impressions is that we need to rise to the challenge that could be posed by what I call the '*trilemma*' facing legal services sector. That is, how do we simultaneously meet the following three objectives without experiencing significant trade-offs among them.

- First, maintaining appropriate standards that command public confidence
- Second, tackling unmet legal need and improving access to justice, and
- Third, recognising the constraints on the availability of public funding.

I am going to take each of these three objectives as a given. The first two reflect goals that unite everyone I have spoken to so far. The third objective is a legitimate policy choice for government and Parliament to make.

So the central question for me is: what is the contribution of regulation in helping to reconcile this potential trilemma?

Encouraging innovation is key

Given the theme of this conference, you will not be surprised to hear me say that encouraging innovation has to be part of our response. This is key to encouraging new products and services and new ways of delivering existing products and services.

And I don't just mean delivered by new entrants, as important as these are. I also mean more established providers feeling able to develop new services and ideas and deliver existing services in new ways.

I appreciate that there may be some areas of our legal services sector where innovation is more likely to take hold than others. For example, those services that meet untapped consumer demand or lend themselves to technology, scale economies and being viewed by the consumer as more of a product than a bespoke service. But that's not to say that all organisations can't

find some new ways of offering services, for example we are seeing solicitor firms and barrister chambers making increasing use of 'unbundled' services by focussing on specific parts of a process rather than providing an end-to-end service.

To give this issue some practical application, let's take for example the unmet legal need experienced by small businesses – a sector that as we all know is essential in driving growth and jobs across our economy. The LSB's research undertaken in 2013, which covered nearly 10,000 small businesses across the country, revealed some stark findings.

- To start with we found that small businesses face lots of legal problems that impact on their day-to-day operations and their growth. 40% of them said they had experienced a significant legal problem within the past 12 months. Over half agreed that legal processes were essential for them to enforce their rights.
- We also found that there were opportunities for legal service providers to address this demand. For example, only one in 20 of the small businesses surveyed had an in-house legal expert and only one in 12 had legal retainer contracts.
- But despite this significant market opportunity, small businesses suggested that existing legal services failed to meet their needs. Over half opted to handle their legal problems on their own. Only one in eight of their legal problems resulted in demand for advice from solicitors firms. And actually only one in eight said that lawyers provided a cost effective means to resolve their legal issues.

We will repeat our SME survey later this year. But I think it is a safe bet that we will still find that the SME sector experiences significant unmet legal need. The 'size of the prize' from innovation that can successfully exploit this is potentially enormous.

I recognise that it all too easy for regulators and policy makers to say 'more must be done' when it comes to innovation – so it is important we have a grounded view on what is actually happening in the sector. This is not a well researched area. This is why, in partnership with the Solicitors Regulation Authority (SRA), the LSB commissioned the Enterprise Research Centre at Warwick Business School to undertake an investigation into innovation in the legal services sector. In the first such survey of its kind, this covered 1,500 organisations that deliver legal services across England and Wales. I want to highlight just a few of the key headlines for you.

- Encouragingly, we found that 80% of organisations felt that they had a culture and leadership that was open to new ideas. 40% of organisations said they had put in place practical procedures to support innovation. Perhaps less encouragingly, only one third of organisations said they regarded as important 'training staff to develop new ideas'. This all translates into the key finding that one quarter of legal services providers said they

had introduced new or improved services in the last three years. Not bad: but room for improvement, especially from the three quarters of organisations that said they had not improved services in the last three years.

- In terms of regulation we found that most organisations believed it had a neutral impact on innovation. Indeed some believed it had a positive impact. The research did identify, however, that there were some key areas where practitioners felt regulation had a negative impact. These areas related to client complaints, client confidentiality and client accounts. For barristers' chambers, professional indemnity insurance requirements were identified as being particularly problematic.
- The study found that Alternative Business Structures (ABS) were more likely to introduce new legal services than other types of regulated organisations. Given that the introduction of ABS was intended to promote innovation and diversity in the provision of legal services, this research suggests that this ambition is in the process of being realised.
- Let's be candid. ABS have not turned out to be the 'bogey men' that some were predicting. But neither have we witnessed a revolution. There are only just over 500 ABS firms out there – some new entrants - and some emerging from more established firms. 500 compares to around 15,000 legal firms.

Stepping back from this, we need to recognise, as I'm sure you do, that the need for innovation is just one challenge arising from the 'digital generation'. It will not come as a surprise to you that for many members of the public who feel they have a legal problem, their first port of call is not to knock on the door of the local solicitors or even pick up the phone to a lawyer. Rather it is to use Google's search engine.

Those involved in online marketing will tell you that page 2 of Google's search results is for losers, you have to be on the first page that comes up. I appreciate it is not robust science, but we have recently undertaken a quick analysis of the first page search results that emerge on Google when common legal need questions are typed into the search engine, such as "legal help for divorce?" or "where to go for legal advice on a will?".

What did we find? Interestingly when it came to will writing the majority of the organisations highlighted were unregulated organisations. For family issues, unregulated organisations featured roughly 50:50 with regulated organisations. In all these searches, charity and third sector organisations also featured heavily.

I use this small example as it highlights the information that is faced by many members of the public in the first instance. It also highlights the competition faced by some legal service providers. By our estimate the unregulated sector accounts for some 20%-30% of total sector turnover. This raises questions for regulators about the boundaries between the regulated and unregulated sectors; something that the LSB will be looking at in more detail later this year.

A ruthless focus on removing unnecessary regulatory burdens is needed

So where does all this leave us? It says to me that regulation and regulators need to really turn their attention to how their rules, procedures and expectations either encourage innovation or frustrate it. This means more focus on deregulation and reducing the costs of regulation.

Don't get me wrong: I am of the firm opinion that public and consumer interests do need to be safeguarded by proportionate regulation, not least public confidence in the system as a whole. I'm not calling for the regulators to dump all their rule books onto the proverbial bonfire. We know only too well from other regulated sectors such as financial services that one person's view on innovation can be viewed by the public as unacceptable risk taking behaviour.

What I do think is needed is for all us legal regulators to start to think about this problem from a slightly different perspective. My impression is that we have a situation where the onus is on those looking to remove regulations to make the case and to assemble the evidence for it. But I wonder whether we would strike a better balance if we followed what is accepted practice in other sectors where it is for those wishing to introduce regulation, or retain it, to provide the evidence for why this is the right thing to do. That is: to reverse the burden of proof around regulatory change.

I am very encouraged that the SRA is already taking this approach having made a bold policy statement in 2013 to do so. I support its ambition to reduce its current rulebook from its current length of 430 pages. If Professor Stephen Hawking can use 224 pages to explain 'A Brief History of our Time' and the greatest ever mathematical problem – Fermat's Last Theorem, which was unsolved for 358 years, – can be finally be cracked in 150 pages; surely there is scope for slimming down our regulatory rulebooks without putting at risk the public interest.

And even where regulations are introduced for sound reasons, it is common practice in other regulated sectors to include 'sunset' or review mechanisms to ensure that rules that were proportionate and designed correctly at one point in time do not become disproportionate with the passage of time.

To help resolve this, we need a really informed view about risk. We may need to ask questions that some folk may find uncomfortable: starting with understanding who we should be protecting from risks; what is the purpose of regulation; and what risks we should be tolerating and mitigating.

We will be assessing the regulators' approach to risk management as part of our review of their performance this year. I am keen that we work with regulators to share best practice as well as highlight areas for development.

Leadership and collaboration is required

In rising to the challenge of innovation, especially given changes in consumer behaviour and technology, it should be recognised that some issues that need to be addressed by regulators extend beyond the scope of one organisation. They are 'system wide' issues. For example, changing consumer demands, the growth of unregulated services, addressing unmet legal need, tackling cyber-crime; they will all rely on strong relationships and organisations working successfully together.

The public's and profession's trust and confidence in our, frankly, rather complex and fragmented system of regulation will start to dissipate if the regulators cannot demonstrate that we can effectively work together on issues of common concern - not least if the cost of regulation is then higher than it needs to be, or the outcome less effective.

I am pleased to say that collaboration among the regulators is happening and is starting to bear fruit. Over the past year, the LSB and the legal services regulators have been working closely together with the aim of lightening the regulatory burden, sharing knowledge, and discussing possibilities for legislative reform. The work has been a real test of whether the regulators could reach agreement whilst addressing fundamental and seriously challenging questions.

This work has produced four key outputs so far – each will be published in the next few weeks.

- First, we have produced a document setting out what each regulator has done to lighten regulatory burdens.
- Second, we have produced a report on alternative ways of handling client money. Misuse of client money is one of the main regulatory risks. It is a risk to clients and to the public's confidence in the legal profession. The legal services regulators have worked together with the aim of identifying alternative – and optional - arrangements for practitioners wishing to avoid the handling of client money. So we are clear, it does not set in train any mandatory changes.
- Third, we have agreed a handful of proposals for changes to the current legislative framework. These are all relatively minor amendments to remove or reduce regulatory burdens.
- Finally, we have developed a paper on the issues that would need to be tackled if there were an appetite to reform the current legislative framework. This is the most challenging

topic. Our aim has been to channel the energy of all of the regulators who, day in – day out, deal with the consequences of the Legal Services Act. It explores the case for change; the case for cross sector-specific regulation; and the definition of ‘legal services’. Different organisations will have different views on the answers to these important questions. The aim of our work has been not to reach agreement on the answers, but at least identify what are the right questions.

In summary

I’ll conclude by drawing my observations together. I am enormously impressed by the fact that everyone I meet can unite around the core principles of upholding the rule of law and improving access to justice. There is a strong public interest prism through which people conduct their arguments about regulation and policy – which is refreshing for me personally having experienced some regulated sectors where tooth and claw capitalism is the prime motivating factor. And it really drives home the point that the legal services profession is much more than a commercial market place.

Although the sector continues to grow when measured by revenue or exports; we cannot be complacent given the challenges of tackling unmet legal need and maintaining appropriate standards while adjusting to reduced public funding – all in a world where consumer demands and technology continue to evolve. Regulators need to press on to encourage innovation and reduce unnecessary regulatory burdens that restrict growth. We also need to work more effectively together as the challenges facing us extend beyond the scope of one organisation.

At the LSB, our role is to provide the public with confidence that the front line regulators are up to the mark. We also encourage change in the long-term interest of the public. As part of this, our new three year strategy for 2015-2018 will focus on:

- *identifying and breaking down the regulatory barriers to competition, growth and innovation, and*
- *enabling need for legal services to be met more effectively.*

There is of course the risk that we may not always agree with one another; but a much bigger risk is that we don’t grasp the nettle and talk about the challenges we face. From the people I have met so far, I am optimistic that we have a solid foundation of insight, goodwill and passion in, and around, our sector to be able to rise to the occasion and make sure that the public interest continues to be at the heart of what we all do.

Thank you for your time this morning.