



The Law Society

Chris Kenny  
Chief Executive  
Legal Services Board  
Victoria House  
Southampton Row  
WC1B 4AD

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Dear Chris,

**Developing Regulatory Standards**

I enclose the Law Society's response to the questions posed in the Legal Services Board's consultation "Developing Regulatory Standards".

We very much welcome the fact that the Legal Services Board characteristically carries out a full consultation before settling its policy on issues on this sort. We think it is important that that approach should continue.

So far as the substance of consultation is concerned, we are concerned that the Legal Services Board appears to be proposing to take a more activist - and more directive - role than Parliament intended when creating the Board.

As you know, it was widely agreed on all sides in Parliament that the Legal Services Board should act primarily as a safety net, leaving lead responsibility for regulation with the approved regulators and intervening only when they appeared to be failing. This view was eventually given legislative effect in sections 49(3) and (4) of the Act.

The Law Society's main reservation about the present paper is not that we do not support Outcomes Focused Regulation - indeed, in principle we support it. But we do not think there are any grounds on which the Legal Services Board can reasonably require all approved regulators to take an OFR approach, rather than the rule based approach which has applied in legal regulation hitherto. It is important that the Legal Services Board demonstrates appropriate restraint, and does not substitute its judgement for that of the individual approved regulators.

More generally, the Law Society is also concerned that the Legal Services Board seems to be searching for a role. The main tasks facing the Legal Services Board when it was set up - establishment of the Legal Ombudsman Scheme, ensuring that approved regulators make an appropriate separation between representation and regulatory activities, and overseeing the introduction of Alternative Business Structures - are now almost complete. In our view the proper response of the Legal



Services Board to that would be to scale back its activities, thus ensuring that the financial burden which it places on the regulated community is reduced, rather than seeking new activities in order to spend the budget which is currently approved.

We look forward to discussing these issues with you further over the months ahead.

Yours,  
Russell

Russell Wallman  
Director of Government Relations

Direct Line: 020 7320 5763  
Direct Fax: 020 7320 5759  
[russell.wallman@lawsociety.org.uk](mailto:russell.wallman@lawsociety.org.uk)





## **The Law Society's response to the LSB consultation "Developing regulatory standards"**

### **Question 1**

**Do you agree with our analysis of the changing legal services market? Are there other factors that should be taken into consideration?**

1. The legal services market is currently going through considerable change. There is plenty of speculation around how the market will evolve in the next five years, but no-one can say for certain what will happen. The analysis provided in the consultation is an interesting contribution to the debate but on its own should not be seen to be a full analysis. The approach taken is a very narrow economic one. The introduction to the analysis - paragraph 33 - is solely focused on competition and business matters. The rest of the analysis follows on in the same vein. It would be misguided for the LSB to ignore the strong professional obligations that will still apply in the "changed context" which the legal services market finds itself in. The nature of professional services is that they respond to needs. Whilst it is important to find innovative ways of responding to need and to help prospective clients to recognise needs, it would not be desirable for legal businesses to develop a larger market by creating unnecessary need.
2. From a research point of view the section of the consultation entitled "Changing context for legal services and thus regulation" did not reference enough empirical evidence for us easily to separate analysis from opinion. It would be helpful if any further analysis could be fully referenced.
3. The Legal Services Act prompted a change to the legal services market that encouraged further competition but at the same time ensured that professional standards rightly maintained a high prominence. Evidence suggests that the Act is already having an impact. A recent survey conducted by Baker Tilly found that some 45% of firms have changed their plan/strategy as a result of the Legal Services Act, while a further 25% expect to do so. There is a "wait and see" approach amongst many firms. Most are not ruling out becoming an ABS but do not have plans as yet to take advantage of these new possibility. The same survey found 8% of firms were defiantly considering having outside investors, 46% were open to the idea and around a third had no interest that.

4. Solicitors as a profession are very adaptable and have modified their practices greatly over the years. Competition, whether it is from licensed conveyancers, unregulated will writers or other solicitors, is not a new phenomenon. It is worth remembering that the Office of Fair Trading enquiry (2000) on restrictions on competition in the provision of professional services found no evidence of cartel behaviour in the legal services market. Lord Hunt of Wirral, in his review of the Regulation of Legal Services, observed: "Since I started practising, the law has become more and more like a business. This continuing trend towards what is now termed "commoditisation" appears to be unstoppable and seems likely to accelerate in the years ahead."
5. The analysis in the consultation does not reflect Parliament's intentions as far as the Legal Services Act is concerned. By allowing non-lawyers to own and manage law firms traditional structures will be exposed to wider competition. Ensuring that there was appropriate separation between an approved regulators representative and regulatory arms means that regulatory decisions will demonstrably be made in the public interest. The LSB was given the important role of creating the overarching structure for these changes to happen, and has the equally important role of being satisfied that rules are being observed. Rather than take a hyper-active role in trying to shape the market the LSB needs to act more a facilitator. The LSB was not created to deliver market reforms beyond those established in the Act itself; its main purpose is to supervise the Approved Regulators (ARs) to ensure that they act in compliance with the regulatory objectives. In paragraph 25 of the consultation the author emphasises the word "must" when quoting Section 4 of the Act "The Board MUST assist in the maintenance and development of standards.." While we would be wary of adding emphasis to any particular word, we believe it is misguided for the analysis to emphasise the word "must" rather than "assist".
6. Paragraphs 44 and 45 suggest that technological advances have lessened the need for a separate business rule to exist. We do not believe that is correct. There is a clear consumer and public interest benefit in maintaining the current separate business rule, which goes beyond any technical advances. Legal regulators have to maintain the right balance between allowing freedom for providers and protection for consumers. The Society believes that all of a SRA regulated firm's legal activities should be regulated by the SRA, rather than some of them being hived off to an associated company outside the regulated sector. Consumers of legal services need to be sure that the legal services they receive are regulated, and that they have appropriate protections.
7. During the process of deciding how to regulate ABS the SRA spent a great deal of time considering whether the separate business rule should be retained or removed. The SRA's application to become a Licensing Authority stated:
8. *"On balance, and having considered the application of the Regulatory Objectives to this issue with care, we have decided to maintain the separate business rule potential*

*for significant areas and volumes of work that is currently regulated by the SRA in the public interest to be de-regulated as a result of removing the rule for both recognised and licensed bodies. Our view is that the maintenance of this rule, through this Chapter, meets the objectives of: protecting and promoting the public interest; protecting and promoting the interest of consumers; encouraging an independent, strong, diverse and effective legal profession; and, promoting and maintaining adherence to the professional principles. In addition we consider our approach to be proportionate in terms of the better regulation principles."*

9. While the Society is pleased that the LSB accepted the SRA's application to regulate ABS, we are concerned that this consultation questions the appropriateness of the rule even though the SRA has very recently spent time considering this matter. There are no grounds on which LSB can legitimately intervene in this matter.

## **Question 2**

### **Do you agree with our focus on outcomes focused regulation; risk identification framework; proportionate supervision; and, appropriate enforcement?**

10. All of the areas mentioned in the question are important components of any regulatory structure; thus the Society agrees it is understandable for the LSB to wish to consider how legal regulators perform in these different areas.
11. In principle the Law Society supports OFR. However, that does not mean LSB should prescribe it for all regulatory circumstances. LSB can only legitimately require that regulators can show that they are meeting all the regulatory objectives contained at the beginning of the Act, it cannot prescribe how they should do so. There are often many different ways to achieve the same goal and it would be wrong to impose a single philosophy on all who fall under the LSB's ambit. The risk in forcing everyone to adopt OFR is that it could push regulators to focus on a narrow set of risks. The consultation paper is so heavily focused on the risk of business failure that it neglects the professional duty aspect of legal regulation. If this approach was mirrored by front line regulators it would be to the detriment of clients - many of whom are anxious and vulnerable when they have to come into contact with a qualified lawyer - and would diminish the reputation of legal professionalism.
12. The thinking behind the consultation paper seems somewhat muddled. For example, it states that it is not the LSBs intention to be prescriptive about how each AR must regulate, but then says everyone must follow an OFR approach. At no point during the passage of the Act was it assumed that all regulators must operate under an OFR system, nor that the LSB would or should require regulators to meet the regulatory principles in a particular way. It is unjustifiable to conclude that the Better Regulations Principles can only be met through OFR..

13. The LSB must itself respect the Better Regulation Principles contained within the Act. It is hard to see how imposing such an approach could be a legitimate use of its powers, being neither proportionate nor targeted at cases where action is needed. It is important that the LSB maintains an appropriate balance between ensuring that all regulators across the legal sector maintain appropriate standards and allowing regulatory arms to act independently. While the Act does charge the LSB with a role in the maintenance and development of standards it does not imply the LSB is to have the leading role, or to impose its preferred systems on all ARs. Section 49 (3) makes it clear that the LSB's principal role is the oversight of approved regulators. Parts of the consultation paper appear to suggest that the LSB believes its primary purpose is to transform the legal services market by taking a directive approach to implementation of the regulatory objectives. This is a misguided approach for the LSB to take.
14. The SRA are introducing an OFR based rule book at the beginning of October, with the Society's support. The Society agrees that there is little point in a regulator promoting the possibility of flexible outcomes if the mindset of regulatory staff is rigidly rule based or if the risk-assessment process does not work well. But it is also worth remembering that it is no small matter changing to a new regulatory mentality, both for regulators and professionals. We believe that during this transition phase it is preferable for the regulator to err on the side of caution when faced with a significant new challenge.
15. The consultation says that the LSB needs more information to assess the impact regulation is having on the legal services market, and then on page 22 states: "We do not underestimate the scale of change that will be needed from the ARs.." As the LSB is aware, ARs have gone through a vast amount of change in the last five years in order to become compliant with the provisions of the Legal Services Act. It would be sensible for the LSB to let these changes embed, and presumptuous to assume that further big changes will be needed soon. In the absence of clear evidence of regulatory failure, these are not matters on which it is legitimate for the LSB to be prescriptive.

### **Question 3**

**How do you think that a more flexible and responsive regulatory regime should be developed?**

16. The question misses the point as to what is important in regulation; namely outcomes. Flexibility and responsiveness are clearly desirable but it is dangerous to look at such factors in isolation from security, confidence, public interest or understanding the specific market within which rules operate. Parliament recognised the uniqueness of legal services by establishing in the Act strong public interest objectives, which should be given very great weight. It is for the regulatory arm of each AR to decide



how best to meet these different objectives. There should be as much regulation as needed, but as little as possible. When it comes to flexibility and responsiveness, regulators should be as flexible and responsive as they need to be to meet the regulatory objectives.

17. The new SRA regulatory regime has been through a long and detailed consultation process. The Society does not believe the time is now right to comment on the responsiveness and flexibility of OFR as we need to observe how OFR is operated.
18. We disagree with the suggestion from the LSB that those regulators who were “grandfathered” under the Act may not operate a regulatory regime that possesses the requisite amount of flexibility and responsiveness. The established regulators retained their position under the Act because of the widely acknowledged quality of their work.

#### **Question 4**

**We would welcome views on whether self-assessment is an appropriate approach or whether LSB should deliver its oversight by conducting its own reviews.**

19. The Society believes that the detail of how to deliver the most effective regulation is a matter for each AR/LA. We agree that the LSB needs to understand how each regulator regulates. Asking each AR to submit a simple self-assessment of its regulatory approach is the best way forward. The LSB should ensure that such a self-assessment is not overly burdensome, and where appropriate fits into the AR's on-going scrutiny of its independent regulatory arm.

#### **Question 5**

**What are your views on the benefits, costs and risks to ARs and their regulated communities of our proposals?**

20. It is right that the LSB develops a mechanism to assess whether ARs are acting in a way that is consistent with the regulatory objectives. The current approach, where the LSB sets out high-level rules for processes required by the Act, and then focuses on outcomes rather than prescribing preferred solutions, seems to us to be broadly appropriate and any new template should build on this. It would be beneficial if a system could be developed that leads to less intrusion and reduces the risk of LSB micro-management.
21. As we have stated when answering the previous questions there is a risk that the LSB concentrates too much on the economic aspect, rather than assessing the performance of ARs against the broader public policy requirements contained in the Act. It is not for the LSB to become a competition authority, especially as there are large parts of the legal services market over which the LSB has no control..

## **Question 6**

**We would particularly welcome feedback on the criteria at Annex A, including suggestions on others that might be appropriate.**

22. No comment.