

Response to Legal Services Board
consultation:

Developing Regulatory Standards

LEGAL
OMBUDSMAN

Thank you for the opportunity to comment on this important discussion paper.

In your excellent paper, you describe your role as making a positive contribution to innovation, access to justice, choice and consumer benefit. You also rightly identify risk – and regulatory responses to risk as being at the heart of effective regulation.

As you are aware, the Legal Ombudsman is also a creation of the Legal Services Act 2007. The establishment of this new service was an active response by Parliament to simplify the system for consumers, so, in this changing world of legal services, there was a clear and accessible route to a safety net of redress.

Our role is two-fold: to provide consumer protection and redress when things go wrong in individual transactions within the legal services market, and also to feed the lessons we learn from complaints back to the profession, regulators and policy makers to allow the market to develop and improve. We have tried to provide you here with a summary of some of the issues we have found from complaints that may assist you develop your approach to regulatory standards, both in developing a framework but also in considering how any framework could work in practice.

Our response

Overall, we welcome this discussion paper and the articulation of a framework for legal services regulation. The principles you set out are sound and consistent with regulation in other areas, whether it be financial services, trading standards, or others – an important consideration given the changing legal landscape.

We were also pleased that your paper did not just look at guiding principles, but at least began to consider the way implementation of this framework might happen. It seems essential for these principles to be backed by enforcement strategies that include a proactive approach to consumer protection in addition to the redress that can be provided by an Ombudsman scheme such as our own. Your paper touches on insurance, which we agree is fundamental to ensuring effective regulation. We are also keen to ensure that the other aspects of consumer protection – speedy discipline and compensation arrangements – tie up with redress and insurance, so that when any of the risks that you outline in your paper do impact on consumers, the system has robust mechanisms in place so consumers benefit from an adequate, joined up, safety net.

The Legal Services Board's (LSB) recent research on first-tier complaint handling has disclosed considerable deficiencies. Against that background, it would be helpful if there were a single set of complaints-handling rules that applied across the legal sector, rather than separate rules from each front-line regulator. A single set of rules would be simpler to communicate to lawyers, consumers and the press - as well as being simpler to operate. This is the situation in other sectors. For example, the same first-tier complaint-handling rules apply across the board to all financial businesses regulated by the FSA and all holders of consumer credit licences issued by the OFT. Such harmonisation within the legal sector will also help towards harmonisation between sectors, as will arise in relation to ABSs.

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

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

We have put together our answers to two of your consultation questions, as, to us, they seemed to be intrinsically linked.

We read with interest your description of the potential impact of Alternative Business Structures (ABS) in this changing market. Much in your paper was based on the assumption that ABS will provide the platform for regulated lawyers competing in this changing landscape – that regulation will allow them to diversify and compete in wider markets and the introduction of ABS will lead to increasing innovation in the legal services market.

We agree that the market is innovating. Since our opening in October 2010, we have seen the impact on consumers of many of the innovations and changes in the way legal services are delivered, all in advance of the advent of ABS. We thought it might be useful to outline some of these innovations to you here in summary, as these issues might assist you develop and refine your approach to developing regulatory standards.

Consumer confusion

We are seeing the consumer confusion that is caused by the overlap between unregulated and regulated services: we often have to put considerable effort into establishing who is a lawyer and therefore falls within our jurisdiction. As it takes us time and effort to do this, it is little wonder that consumers of services are unclear and confused about how to seek help and redress in what remains a complex system. The interaction between claims management companies (CMC) and lawyers are a current illustration of this issue – we are seeing an increasing diet of cases where a consumer thinks they have bought a service of a lawyer, when in fact it is a CMC that they have a contract with, thus falling out of the protective net of our jurisdiction. Will writing is another such example; you are, of course, aware of these issues through your recent review into this area.

A key tenet of the Act, as you rightly describe, was to bring consumer benefit from innovation and increased choice through competition in the legal services arena. What the cases we are seeing highlight is that, as is to be expected, business innovation can, and is, happening independently of regulatory structures and frameworks. What we are concerned about is the impact on the consumer and how your proposed approach to regulation will help us all achieve greater clarity in this increasing complex market place.

Technology

We are also seeing innovation in legal services and the impact that has on consumers. You rightly point to increased use of technology to deliver services: purchasing legal (or other) services on line comes with its own set of specific issues for consumers, not least when something goes wrong with a transaction. Many of these issues are not unique to legal services. We are seeing some evidence of an increasing number of 'phoenix' firms, who close and re-open as different structures, leaving the fall out for their individual customers. Where we can help, the Ombudsman must grapple with the fact that, irrespective of our decision in a case, if the firm has disappeared, there may be no mechanism to ensure a remedy is provided.

Due to this, as noted above, we welcome your focus on enforcement strategies. We are keen to work with regulators to join up redress with other forms of protection such as insurance and compensation arrangements, as, when a firm is no longer in existence, we all, consumers and the Ombudsman alike, must rely on comprehensive structures being maintained by the Approved Regulators to provide this part of the safety net.

We are also seeing evidence of firms, who, perhaps inspired by the cut-price airline market, offer attention grabbing headline prices, only for many add-ons to increase the final price to significantly different levels. The key difference seems to be that, unlike the process of checking in at an airport, your average consumer is unlikely to be aware of what are the normal steps in a conveyancing or probate transaction, and so are unlikely to be aware of what is a fair price for this work. Online firms are also engaged in sub-contracting out the provision of the reserved legal activity meaning that we see many layered and complex business structures, some of which can fall within regulation, and some without.

These must be commercially viable, given that we are starting to see them more regularly on the open market.

For us, these examples leave us with a need to clarify the bounds of our jurisdiction – consumers deserve clarity about when and why they are able to access redress for some of these business models but not for others. The advent of ABS will add another piece to this emerging jigsaw; we agree it provides an additional mechanism for regulated lawyers to look to innovate and develop their business models. However, the complaints we are seeing tell us that companies are finding ways to do this without the regulatory framework outlined in your discussion paper, leaving evidence of consumer confusion about how to find help when things have gone wrong. Rather than just being part of a changing legal services market, it seems that what we are seeing is a changing approach to how more complex consumer services are delivered more generally – a joining up across financial, property, accountancy and other services that needs a less segmented response to regulation and redress.

We would welcome further debate and discussion about how the principles in your discussion paper extend past formalised structures like ABS, to these other, equally dynamic business models that are already emerging.

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

As touched on earlier in our response, we do agree with the focus of the discussion paper. In particular, we think your focus on risk as a way of identifying regulatory issues and responding to them is essential. Your paper began to touch on some of the ways this might be implemented by the different Approved Regulators. We appreciate and agree that it is not the role of the LSB to be prescriptive in how implementation should occur, nevertheless, there may be some important practical issues that need attention. For instance, how will risk be assessed? In our own work, we are very aware that we may see more complaints from lawyers or firms that work in more contested areas of law, for instance, family law, criminal law and other areas where there may be a higher incidence of other factors such as mental health issues. How will these factors be evaluated in the context of an overall risk management framework? We

would be interested in your equality impact of the principles in the discussion paper, not least to help us inform our own approach to some of these important issues.

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

Self assessment is certainly consistent with the principles to regulation you outline in your discussion paper. In your principles however, you also emphasise the need for consistency. And this seems to be the risk associated with a self-assessment process, not least, as it also relates to your other pertinent question about whether each of the Approved Regulators have the skills, resources and ability to deliver within the framework you set out. From our own experience, we know that our colleagues in each of the legal regulators are committed to ensuring robust and effective regulation. They, like the legal services market, are going through a significant period of change, while also needing to grapple with increasingly complicated regulatory issues, some of which we outlined above.

We do not have a view on whether the LSB should conduct its own reviews or not; we would like to see in place whatever mechanism means that you, as oversight regulator, can best support and assist the Approved Regulators achieve the standards you have set out in this paper. To do this, we assume you would also need a way of 'levelling' the approach across the different parts of the profession to maintain consistency whilst also recognising that each AR is different to assist you measure success and spot issues.

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

We have also sought to consider the impact on consumers of legal services of your proposals, as well as the other people and institutions you mention in your question. As consumers are the people that regulation is there to assist, and it is them who we hear from when things

have gone wrong, we thought it would assist you for us to include them in our response to this question.

Benefits:

- Increased consumer choice in the way legal services may be delivered
- Greater consumer confidence i.e. that the legal sector is being regulated properly and that the frontline regulators are accountable
- A consistent approach to regulation across the different parts of the legal profession (where historically there has not been a joined up approach)
- A less intrusive management/regulatory style
- Allows Approved Regulators to develop in their way, but within set parameters, so they can choose how to effectively deploy resources
- Should help improve quality and consistency across the legal sector
- Outcomes focused regulation will mean that the sector can focus its attention on the purpose of the rule, rather than adhering to the letter of the rule.

Costs:

- Cost of adherence to a changing regulatory landscape will be passed on to consumers of legal services
- Complexities of new business models – firms may find structures that minimise regulatory costs for them, meaning that consumers may fall outside regulatory protections
- The costs involved in carrying out any self review – would this need to be a special project, separate to any previous/current self reviews undertaken by the regulators?

- Will the risk scale mean that high risk firms have more restrictions placed upon them – could this potentially incur costs?

Risks:

- That there is no obvious change/improvement after the new standards have been implemented – especially to consumers.
- A lack of knowledge and expertise in new areas of business that come into jurisdiction i.e. ABS
- That firms continue to find ways to innovate that mean they remain on the edges of regulation – and this is confusing for consumers
- Potential of regulatory creep and blurring of the distinction between minimum standards and best practice –regulators may end up holding a firm to account for a standard which the firm voluntarily adopted although the regulatory rules states that the firm is not required to achieve compliance.

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

We have touched on some issues throughout our response that may be relevant to the issues you touch on within Annex A. We have sought here to highlight a few additional issues that we have not mentioned earlier.

Outcomes focused regulation

- We welcome the fact that the first outcome links in with the codes of conduct and the consumer experience.
- The outcomes seem fair and are supportive of both the consumer and the firm.

Risk Assessment

- We would like to understand in more detail the role of the Legal Ombudsman in this area – how do you see our role in feeding into the process? Part of our remit is sharing learning and feedback to the profession and we would welcome the opportunity to assist in this area.

Enforcement

- You mention publicity around enforcement, and we would be interested in more detail about what you think this might entail. As you are aware, we are currently consulting on the issue of publishing our decisions, and it may be that your thinking in this area is relevant to our considerations.

Thank you again for the opportunity to respond to this discussion paper. If you would like to discuss in more detail any of the issues raised here, please contact Sian Lewis, Policy and Research Officer, Legal Ombudsman at sian.lewis@legalombudsman.org.uk.