

A blueprint for reforming legal services regulation

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Chairman's foreword

Overview

1. Six years ago I was invited to apply for the chairmanship of the soon to be created Legal Services Board (LSB), to be set up following the enactment of new legislation - the Legal Services Act 2007 (the Act)
2. During the selection process I was asked if the Act could deliver its purposes - changing a regulatory regime from one that protected suppliers to one with the consumer at its heart; delivering a route for alternative business structures to break into a closed marketplace; and creating a proper system for dealing with consumer complaints and offering redress.
3. My reply was honest - "I don't know - ask me in five years". I did not have a better answer then because the Act was a monumental four hundred pages, two hundred and fourteen clauses, and twenty four schedules. As it had passed its various stages, lobbying had added complexity and qualification making infinitely more difficult the delivery of Sir David Clementi's goals - the promotion of the consumer interest, competition, innovation and transparency.
4. But the goals seemed to me then - as they do now - not only valuable in social terms but fundamentally important in economic terms. Ensuring the health and vitality of the legal sector should be of primary importance for regulators and government. The sector:
 - is central to the maintenance of our democratic system. Access to justice is a cornerstone of democracy;
 - underpins the operation of the law, which in turn supports all economic activity including the growth and development of new businesses;
 - employs 320,000 people and has an annual turnover of over £25 billion, and is of major economic importance in its own right.
5. The rationale for regulation is also about addressing market failure. Arguably, the biggest market failure in legal services is that for a large proportion of the population, including many small businesses, there is no affordable supply. And there is limited choice for those who can afford services.
6. Looking back, I would argue that the LSB has delivered to a significant degree the priorities of the Act - we have driven through major shifts in the way in which regulation is carried out by focused regulatory bodies, and detached from the special interests of the profession; we have set up a fully functioning complaints resolution body; and two hundred and fourteen alternative business structures now exist, with over one hundred being considered.
7. We have achieved that through an unremitting focus on progress - acting as a constructive change agent. The landscape has fundamentally altered.

8. But progress towards an effective, functioning marketplace has often been painful. The complexity of the Act has made institutional and cultural rigidity easier to maintain and sustain.
9. I therefore accept entirely the argument that the post-2007 Act regulatory regime can be reorganised and simplified to deliver the real potential of the Act.
10. This document sets out a series of proposals based on the five years experience of the LSB. In this foreword, I set out a prescription for a regulatory framework that is simple, promotes the economic well-being of the legal sector and ensures essential protections for consumers.
11. But our prescription does not turn the clock back. My belief is that more not less change is needed in mechanisms for market entry; regulation needs to be further detached from the influence of the provider towards the consumer; and simplification at every level can be delivered.
12. The last five years have seen an unprecedented period of change, with improvements in regulation helping to foster a range of new legal businesses. The reforms in the Act have allowed new investment in, and non-lawyer management of, legal firms. Regulators have increasingly started to express requirements in terms of outcomes, which can be met in many ways.
13. That very success has shown that radical change is needed to simplify regulation further and target it more effectively. More can be achieved, faster, with a simpler statutory framework and bolder, more market sensitive, more independent and less risk averse regulators.

Existing complexity

14. There is no doubt that the current regulatory framework is over-engineered and exceptionally complex:
 - ten front line regulators, an oversight regulator and a statutory ombudsman scheme operate in a legal framework of at least ten main statutes and dozens of statutory instruments, while trying to promote eight different regulatory objectives;
 - the front line regulators operate inconsistent codes of conduct and/or rule books. The Solicitors Regulation Authority's (SRA's) main rule book is 511 pages long; the Bar Standards Board's (BSB's) is 372 pages long. They contain a bewildering mix of outcomes, behaviours, principles, rules, guidance and policies;
 - legally, only six "reserved legal activities" actually require regulation. The identification of these activities is an accident of history, unrelated to risks to today's consumers; most other areas of law can be provided without any regulation at all;

- and once a person is regulated (traditionally based on title such as “solicitor” or “barrister”) the unusual case, the highest risk, or the worst behaviour of any market participant may be used to justify uniform codes of practice that place significant regulatory costs and prescription on a wide range of legal and non-legal activity to the detriment of innovation.

15. This complexity arises from:

- incomplete liberalisation in 2007 and after - the Act carried over the existing statutory and rule-based frameworks, rather than there being a thorough overhaul. Unsurprisingly therefore, some liberalising steps taken by regulators have been seen by the market as adding costs, rather than removing burdens eg outcomes focused codes where traditional businesses are used to rules;
- the institutional framework of regulatory bodies tied to professional organisations - a legacy of over-detailed rules and cultural biases tends to preside over rigid entry controls, detailed system requirements and regulatory interference in decisions that are better left to commercial entities eg continuous professional development requirements.

16. The result is a situation where firms face a common regulatory cost base unrelated to the risk they present, a cross-subsidy of bad firms by good. That leads to unnecessary costs for law firms, but also costs to UK plc through reduced competition, innovation and consumer choice.

17. Multi disciplinary practices were meant to be a key feature of the post Act legal services market - delivering better and cheaper services across the full range of consumers. However, there is growing evidence that the conservatism of the legal profession and its regulators continues to make it difficult for new provider types to enter the market, especially those with truly innovative delivery models. A combination of the prescriptive requirements of the Act, regulators’ inherent discomfort with other professional services and specific rules such as the SRA’s separate business rule is delaying approval of firms seeking to offer multi-disciplinary services.

18. Nor does the current level of regulation make services accessible to consumers or build confidence in the legal system:

- LSB consumer research found that consumers took no action in response to 13% of all of the legal problems they faced and handled a further 37% themselves without any help;
- LSB small business research found that, while 54% of small businesses agreed that “legal processes are essential for businesses to enforce their rights”, only 12.6% agreed that “lawyers provide a cost effective means to resolve legal issues”, with 45% disagreeing.

The way ahead

19. Therefore, it is my view that a new framework is needed to:

- secure a liberalised market, offering greater innovation, choice and value to support growth, improve access to advice and ease dispute resolution for consumers and business alike and facilitate the export of UK Law;
- tackle major risks to both public and consumer interest proportionately.

20. Both outcomes are equally necessary. Legal services that offer greater protections for consumers, but also are too expensive for the majority of consumers to afford, would be a poor policy outcome. Equally, a regulatory free-for-all would undermine public confidence and the wider civic role of the law.

21. This is not an issue for a 'quick fix'. But nor is it one to be put on the 'too difficult' pile and ignored. There are opportunities for early progress, but these need to be set in a longer-term context which will in my view necessarily lead to consideration of structural change. 'What' is regulated and 'how' it is regulated are more important questions than 'by whom?'. Current fragmentation adds costs, generates inconsistency and depresses innovation to the detriment of consumers and providers alike.

A new conceptual framework

22. Some important building blocks can be put in place by ensuring existing regulators ruthlessly target regulation at identified risks. But specific legislative simplification is also desirable. I do accept that any change of structure will take years, and require primary legislation. I believe that to make rapid progress, a new conceptual framework is a necessary, rather than sufficient, condition for simplified regulation. Less needs to be done, but what is done must be done better.

23. The LSB therefore sets out in this paper a clear plan for incremental but significant change. We propose:

- a short-term action plan to simplify, rather than fundamentally replace, the legislative framework for legal services significantly over the next 2-3 years if a vehicle can be found. This will reduce the cost and complexity of regulation;
- better targeted and proportionate regulation;
- an independent review to develop timetabled and costed proposals to develop a new framework of regulation that is structurally, legally and culturally independent of professions and Government;
- the core model to be tested in this process should be a single legal services regulator unrelated to any existing regulator, including the LSB, with professional bodies playing a standard setting role rather than controlling the right to offer services .

24. As in other sectors, the core protections for legal services consumers should lie in general consumer law, as reinforced by the proposed Consumer Rights Bill, and by

enhanced access to redress, rather than via a panoply of sector specific rules. This would mean the removal of much of the sector-specific regulation for those law firms that provide only lower risk activities. Similarly, I see little reason to retain many of the existing regulatory requirements, for example about consumer care, on corporate law firms given the sophistication and purchasing power of their clients. Instead, regulation of corporate law firms should be focused on risks to the public interest and on core maintenance of the rule of law.

25. There should be a much stronger emphasis on consistent consumer redress.

Developing consumer protection laws should be complemented by access to the Legal Ombudsman (LeO) or other alternative dispute resolution (ADR) service for all individual and small business consumers of legal services. Protection for these consumers would be more comprehensive than at present, without all legal services providers being subjected to wider sector-specific regulatory requirements.

26. All sector-specific regulation should be targeted depending on the nature of the risk and effectiveness of tools available. Higher risk legal activities such as handling client money, litigation, advocacy in court/tribunals especially on issues of liberty, mental health matters and the provision of immigration and asylum services would be priorities for any regulator. Authorisation to provide such services, specific ongoing requirements and supervision of delivery should be based on assessment of risk and focused on outcomes, rather than being uniquely related to professional title. Generally, regulation would be directed at entities delivering the service, unless the nature of the risk made individual regulation essential.

27. This would allow regulation to focus resources on areas of potentially significant detriment to individual consumers and small businesses. Firms operating in those areas of the legal services market(s) would experience regulation that was tailored to the services they provide and the consumers who use them, with fewer regulatory barriers to innovation and commercial enterprise.

Legislative and regulatory simplification

28. I consider that, until regulation is truly legally and culturally independent and evidence-based, existing regulators will be less likely to target their regulation on higher risk areas and entities, reduce regulation in lower risk ones and respond to changing risks.

29. I repeat: progress has been made, but more change will be needed and this will not be easily secured. In the short-term, we believe that a hands-on approach by the LSB is essential to the delivery of effective changes to regulatory culture and a rapid reduction in cost and complexity of regulation.

30. Specific legislative and/or regulatory change could start the process of change by helping to secure:

- significantly lower barriers to entry and reduced costs;
- structural simplification;
- changes to enable more efficient use of the tools the LSB has been granted by the Act.

31. Although many of these changes - summarised in the next paragraphs - would require primary legislation, they would not call for wholesale revision of the current framework. Further detail of the proposals and the benefits that they would bring are in section 9 of this paper.

32. Lower costs and entry barriers could be achieved by:

- removal of the ability of professional bodies to levy compulsory fees for non-regulatory activities – some £20-25m in total is currently levied in addition to the actual costs of regulation;
- a new simple 'fit and proper' test for alternative business structure (ABS) owners, replacing the 20 pages of Schedule 13 to the Act;
- permitting market entry to provide most legal activities unless a regulator has clear evidence of likely potential harm;
- fully aligning the reporting rules for infringements for ABS and non-ABS firms;
- fewer restrictions on in-house solicitors acting direct for the public, creating more competition and diversity in the market.

33. Structural simplification could be achieved by:

- a general power for regulators to make the rules that are required by the Act to allow regulation to be amended in time with market developments;
- a single approval process for the entry of new regulators and licensing authorities;
- simplified consultation arrangements - removal of the requirement for the LSB to consult the Office of Fair Trading (OFT) (soon to be the Competition and Markets Authority(CMA)), the Legal Services Consumer Panel and the Lord Chief Justice;
- cutting out the dual approval for new regulators by Lord Chancellor and LSB;
- faster Parliamentary process for becoming an approved regulator or licensing authority;
- economies of scale and greater consistency of decision-making through rationalisation of the current sanctions and appeals arrangements.

LSB facilitating change

34. To steer change in this direction in the short-term, improvements are needed in the LSB's powers. This should include the LSB having a remit to review existing arrangements and, where necessary, require reform to meet the better regulation principles. Specific changes include:

- less prescription in the rule change approval process set out in the Act;

- ability to “call in” existing rules and processes for assessment, particularly unsuitable rules set by the approved regulators prior to the Act;
- placing the LSB and front-line regulators under a duty to simplify regulatory arrangements where possible to align with the better regulation principles;
- less prescription in the LSB’s enforcement powers and repeal of Schedules 7, 8 and 9 (14 pages of legislation) to provide more consistency with better regulation generally and the Macrory principles¹ in particular.

35. The LSB also intends to consult shortly on the introduction of a rule stipulating lay chairs for the boards of all approved regulators. Three out of the six regulatory boards currently have a lay chair. To give confidence to consumers over the independence of regulation from vested interests, and to help drive cultural independence, we will consider whether this should be made mandatory for all regulators’ boards.

36. A new duty on the LSB to ensure that consumers have access to proper redress services could replace the current detailed controls on matters of appointment to and performance monitoring of the Office for Legal Complaints (OLC), as LeO begins to address the opportunities presented by transposition of the ADR Directive.

Change in the long term

37. Although these changes are ambitious and detailed, I believe that the real goal of reduced, but more effective, regulation could be most securely built on a new paradigm, rather than within the existing framework or through incremental changes to it. While this is not practicable in the short-term, it is not too early to begin to think through its core statutory and institutional ingredients.

38. A simplified statutory framework, in a single Act significantly shorter than the current one, is needed to ensure that regulators have only those powers needed to carry out their (reduced) functions with the aim of securing:

- consistency of approach to give certainty to consumers and provider alike and discourage potential ‘forum shopping’ for particular regulators by the regulated community;
- reduced barriers to entry to stimulate innovation and competition;
- targeted, proportionate regulatory supervision based on real, evidenced risk faced by individual consumers and small businesses – which will, implicitly, differ for different market segments and different consumers;
- adequate powers and incentives to introduce real better regulation.

39. Much of the existing sector specific rule books could be removed, with development of professional standards around the award of title left exclusively to

¹ <http://webarchive.nationalarchives.gov.uk/+/http://www.bis.gov.uk/policies/better-regulation/reviewing-regulation/improving-compliance-among-businesses>

professional bodies. And such a framework is likely to demand a new regulatory infrastructure better suited to deliver risk based regulation.

40. The LSB has explored a range of options set out in this paper. The core personal hypothesis is that we should begin working towards a single smaller cross-cutting regulator with sector specific skills but also with a deep understanding of the public interest, consumer rights and market efficiency issues - a different skill set to that generally found in today's multiplicity of title-based regulators.

41. Such a body would need to be created from scratch, rather than from the LSB or current approved regulators. It should be organisationally, statutorily and culturally fully independent of both government and representative bodies' vested interests. In turn, its own rule book should start from a blank sheet of paper - informed, but not constrained, by current requirements with no 'passporting in' of old rules. A new code of ethics and behaviour set by the regulator would cover all individuals offering regulated legal services, backed by proportionate requirements focused on entities where needed. There would need to be careful arrangements to ensure that regulatory independence does not turn into unaccountable regulatory creep, but strong consumer and practitioner voices and Parliamentary scrutiny could all play a part in that.

42. Progress can be made in the short-term without such change. The other options discussed in the paper have some merits and could be alternative models or a useful starting post towards more radical simplification. But the labyrinthine 2007 settlement is living on borrowed time. It has done its job, but the cracks are beginning to show. Hence our proposal to develop a more refined model and a costed and timetabled implementation plan to develop its replacement now. A return to past methods of pure self-regulation or bodies based on rigidly defined professional roles no longer recognised by many practitioners and in which non-lawyers never offer legal services - is not an option.

Conclusion

43. This paper therefore develops the arguments 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;
- legislative changes could produce further quick reductions in regulatory burdens;
- a simplified regulatory structure could be developed that would further reduce regulatory burdens.

44. The arguments are not about self interest: they are founded on five years' experience of making the Act work. We are proud of what we have secured. So this paper is much wider than a response to the Ministry of Justice call for evidence - it is a blueprint for a reformed and energised regulatory regime.

A handwritten signature in black ink, appearing to read "David Edmonds". The signature is fluid and cursive, with the first name "David" being more prominent than the last name "Edmonds".

David Edmonds
Chairman, LSB

1. Structure of this response

Section	Title	Key points outlined
2	The legal services market	<ul style="list-style-type: none"> • What the market looks like • The various layers of regulation applied to legal services • Research on individual and SME consumers' experience of legal services
3	Understanding the problem with regulation	<ul style="list-style-type: none"> • Problems with the complex structure of legal services regulation • Drivers of excessive regulatory burdens • An assessment of the current structure and regulation against each of the principles of better regulation, and consideration of an additional principle of promoting economic growth
4	Why independent regulation?	<ul style="list-style-type: none"> • Previous experience of self-regulation in the sector • Problems resulting from a lack of full independence
5	Independent oversight	<ul style="list-style-type: none"> • Why independent oversight is needed • Ten of the LSB key functions, what they entail, what their objectives are, what came before the LSB and an analysis of success
6	Reforming regulation, reducing burdens	<ul style="list-style-type: none"> • The need to target regulation on risks • Three key areas of risk: the public interest; the consumer interest in quality of service; and the consumer interest in the protection of client money • The regulatory tool-kit that can be used flexibly by regulators • The appropriate use of tools to address identified risks • The need to accept the limitations of regulation
7	Regulating legal services by risk	<ul style="list-style-type: none"> • A different approach to that centred on the reserved legal activities: <ul style="list-style-type: none"> ○ All legal activities would be subject to a common baseline of protections consisting of access to an Ombudsman or other ADR plus existing and new consumer and criminal law ○ Only above this, a risk based model of regulation • Obstacles for the existing regulators • Proposals to work towards this new framework
8	More comprehensive redress, less regulation	<ul style="list-style-type: none"> • Broadening consumers' right of access to redress for all legal services • Developing the role of the OLC to enable it to play this enhanced role • Breaking the link between redress and regulation to ensure that these additional consumer rights do not generate unnecessary further cost for firms
9	Options for change	<ul style="list-style-type: none"> • Changes and legislative simplification that could be achieved either immediately or following the passing of the Consumer Rights Bill • Suggested shorter term changes grouped under the headings of: <ul style="list-style-type: none"> ○ Lower costs and entry barriers; ○ Structural simplification; and ○ LSB facilitating change • Legislative changes outside the Act • Longer term issues: titles and professional privilege
10	A long term	<ul style="list-style-type: none"> • A single sharply focused regulator is likely to be best placed to

	vision for regulatory structure	<p>deliver effective legal regulation in line with the principles of better regulation</p> <ul style="list-style-type: none"> • Significant challenges to achieving this in the near-term • Important changes that can be made through more incremental reform should not be delayed
11	Conclusion	<ul style="list-style-type: none"> • Existing legal services regulation is failing to meet the principles of good regulation • Introducing full independence of regulators from the profession is essential • A tighter focus on risk • Immediate simple legislative changes • A simplified regulatory structure

2. The legal services market

1. This section outlines:

- *What the market looks like*
- *The various layers of regulation applied to legal services*
- *Research on individual and small and medium enterprises (SME) consumers' experience of legal services*

The market

2. The complexity of the legal services market has contributed to the cost and complexity of statutory sector specific legal services regulation².

Providers

3. The legal services market employs 320,000 people and has an annual turnover of over £25 billion, so is of major economic importance in its own right³. There are many different types of regulated and unregulated providers delivering different types of legal services to different types of consumers in different sectors of the economy. In the regulated sector, providers range from firms with turnover of £1bn and over half their revenue being generated internationally, producing major export returns for the UK, to small firms with turnover of £200,000.

4. In terms of number of firms, the market is dominated by small partnerships, the majority of which are sole practitioners. Conversely, LSB analysis of SRA turnover data has found that 50% of solicitors firms in England and Wales hold 97% of the market share. The last five years, since the introduction of the Act, has seen an unprecedented period of change with improvements in regulation helping foster a range of new legal businesses (see annex E). The reforms introduced have allowed new investment in, and non-lawyer management of, legal firms. However, in large parts of the regulated sector there remains limited difference between business models and the way that services are offered. One example is the prominence of face- to- face advice and hourly billing. This limits choice for consumers and may indicate a lack of competitive pressure.

5. While we have focused our attention in this paper on regulatory matters it is essential to recognise the wider changes affecting law firms both in England and Wales and in a wider global context. The globalisation of legal services businesses is likely to increase further in the coming years as technology further increases the potential for outsourcing (sub-contracting part of a piece of work); offshoring (placing sub-contracted work overseas); onshoring (placing sub-contracted work within the country of origin) and fully replacing lawyers with technological solutions

² For information on the cost of regulation of solicitors see Legal Services Board *Breakdown of The Law Society & Solicitors Regulation Authority budgets showing Practising Certificate Fee (PCF) Expenditure*, 2011/12: http://www.legalservicesboard.org.uk/Projects/pdf/20130226_SRA_PCF2011App_WEB.PDF

³ Office of National Statistics *Annual Business Survey* (2012) www.ons.gov.uk/ons/datasets-and-tables/index.html

(eg discovery). In the UK we expect the entry of new ABS business models to accelerate these trends.

6. Legal businesses in England and Wales face pressures both from the emergence of new businesses and new technology as well as from wider government reforms. Cuts to legal aid and reforms to the personal injury market, through the Jackson reforms, have added to the pressure on many legal businesses. At present evidence from analysis of market data (see Annex E) does not suggest significant levels of market exit (certainly not once considering levels of market entry) but undoubtedly legal firms are currently seeing more pressure than usual on their profitability.

Consumers, legal activities, types of problem

7. The LSB published a report by Oxera Consulting in 2011 that developed a framework for analysing legal services⁴. This report segments the market by consumer type, problem type/area of law and activity. Risks and issues vary significantly across these segments.
8. *Consumers* - there is a huge variation in capability across consumers of legal services, from economically disadvantaged users of legal aid through individuals who may face few legal problems in their lifetime, small businesses that have regular legal problems but little legal experience, to large corporate users of legal services. These differences impact on the affordability of legal services and consumers' ability to identify the legal services they need and manage the services delivered.
9. *Activity* – the Oxera report illustrates the scope of legal activities from relatively simple services such as document preparation through advice on (potentially) litigious matters to legal representation (often in court). The consequences of bad service or advice in any of these activities are likely to vary both by the activity itself, the type of problem/area of law and also by the customer type.
10. *Problems/ areas of law* - consumers face different types of problems in different areas of law, which will drive the type of legal service (activity) that is needed. The severity of the consequences resulting from unjust outcomes and whether or not they are reversible will also depend on the problem and area of law. For example, the consequences of the outcome of an asylum seeker appealing the state's decision to deport them are very different from those of a consumer seeking compensation following a poor plumbing job.

⁴ For a summary of the Oxera framework see the LSB research website at <https://research.legalservicesboard.org.uk/wp-content/media/Summary-Oxera-June-12.pdf>

Regulation of legal services

11. It is important to see the regulation of legal services in its widest context, encompassing all 'rules of the game'⁵. In this context the costs imposed on those within the market start with general law applying to all people, all businesses and all activities, ie civil and criminal law. The particular protections, how they can be enforced (eg by public authority or by individuals through the court system) and whether or not redress for the consumer is likely to be secured all differ depending on the nature of the problem (see annex B).
12. For lawyers, as with most other professionals in other sectors, a further level of informal regulation exists. The rules and cultural norms set by professional bodies (eg through quality schemes, practice notes, professional ethics, assimilated values and behaviours etc⁶) act as regulation that imposes costs on businesses operating in the market and dampens incentives to innovate in the way services are delivered. Whether such norms are appropriate should therefore be judged on the same cost-benefit calculations as statutory regulation.
13. In legal services there is also more formal regulation controlled by the sector specific statutory regulators. These are each charged with regulating their individual arms of the profession, which they authorise to undertake reserved legal activities⁷. As there are eight active approved regulators, each with close links to professional bodies, the LSB has been introduced as an oversight layer with a number of functions, including ensuring the independence of the individual frontline regulators and keeping an appropriate regulatory floor in place (see section 5). Finally, there are other sector specific statutory regulators outside the Act for some services that are legal activities under the Act. These including the Office of the Immigration Services Commissioner (OISC) (overseen by the Home Office), the Claims Management Regulator (CMR) (overseen by the Ministry of Justice) and numerous regulatory bodies for insolvency practitioners (overseen by the Department for Business Innovation and Skills (BIS))⁸.

The consumer experience

14. It is easy to forget that, by fee income generated, the majority of consumers of legal services are large businesses with considerable purchasing experience who often employ a team of lawyers to buy on their behalf⁹. But, keeping risk in mind, our focus remains on the parts of the market where individuals or small businesses

⁵ Regulatory Policy Institute *Understanding the Economic Rationale for Legal Services Regulation* Report for the Legal Services Board prepared by Dr Christopher Decker & Professor George Yarrow (October 2010) <https://research.legalservicesboard.org.uk/wp-content/media/Why-regulate-legal-services-RPI-report.pdf>

⁶ It should be noted that there can be external drivers for quality schemes such as the tender requirements of bulk purchasers of legal services, insurance criteria etc

⁷ The list of activities set out in the Act that only individuals and entities authorised and overseen by relevant legal services regulators can undertake reserved legal activities

⁸ Insolvency Practitioners can gain licenses from one of seven bodies designated by the Insolvency Act 1986, or directly from the Secretary of State for BIS

⁹ The Law Society *Estimated Work for Businesses and Retail Work* Slide 12, Legal Services Part 3 Key Markets (July 2013)

are the consumers or where risks exist to the wider public interest. However, research by Kershaw and Moorhead identifies the risk to the public interest by activities even in the corporate market, particularly as corporate lawyers assist in large scale financial transactions that can have implications for the wider economy¹⁰.

15. The LSB has extensively researched the consumer experience of legal services both from the perspective of the individual¹¹ and small businesses¹². A clear finding from our research is that for the majority of consumers for the majority of problems with a legal solution, regulated legal services providers are not used. For individuals only 21% of justiciable problems used regulated legal providers and this fell to 17% for small businesses. Just over half of individual consumers and nearly three quarters of small business consumers either take no action or solve their legal problems themselves or with help from friends and family.
16. It would be wrong to characterise these decisions as irrational. The research we commissioned on behavioural economics¹³ helps to explain how individuals use simple rules to help them navigate complex markets such as legal services. The view that consumers take rational, albeit simplified, approaches to solving their legal problems is supported by our in-depth research exploring these issues with consumers. While much about the legal services market can be improved, consumers generally are able to find the support they need. We should be doubly careful therefore in seeking regulatory intervention to protect consumers where evidence of consumer problems is thin and regulation could drive up costs and inhibit the development of a market that may benefit consumers. Better protection for a smaller number of more affluent consumers would be a poor policy outcome – for both the citizen and the economy. LSB small business research¹⁴ found that, while 54% of small businesses agreed that “legal processes are essential for businesses to enforce their rights”, only 12.6% agreed that “lawyers provide a cost effective means to resolve legal issues”, with 45% disagreeing.

¹⁰ Kershaw D and Moorhead R *Where were the Lawyers when Lehman Crashed?* (January 2013) <http://www.lse.ac.uk/collections/law/news/Times%20Where%20were%20the%20lawyers.pdf>

¹¹ BDRC Continental *Legal Services Benchmarking* Report 11516 (June 2012) <https://research.legalservicesboard.org.uk/wp-content/media/2012-Individual-consumers-legal-needs-report.pdf> and Optimisa Research *Consumer Use of Legal Services: Understanding Consumers who don't Use, don't Choose or don't Trust Legal Services Providers* (April 2013) <https://research.legalservicesboard.org.uk/wp-content/media/Understanding-Consumers-Final-Report.pdf>

¹² Pleasance P and Balmer N *In Need of Advice? Findings of a Small Business Legal Needs Benchmarking Survey* (April 2013) <https://research.legalservicesboard.org.uk/wp-content/media/In-Need-of-Advice-report.pdf>

¹³ Linstock Communications *Understanding Decision Making in Legal Services: Lessons from Behavioural Economics* (June 2013) <https://research.legalservicesboard.org.uk/wp-content/media/Behavioural-Economics-Final.pdf>

¹⁴ Pleasance P and Balmer N *In Need of Advice? Findings of a Small Business Legal Needs Benchmarking Survey* (April 2013) <https://research.legalservicesboard.org.uk/wp-content/media/In-Need-of-Advice-report.pdf>

3. Understanding the problem with regulation

17. This section outlines:

- *Problems with the complex structure of legal services regulation*
- *Drivers of excessive regulatory burdens*
- *An assessment of the current structure and regulation against each of the principles of better regulation, and consideration of an additional principle of promoting economic growth*

Problems with the existing structure

18. Our assessment of existing legal services regulation is that it imposes too high a burden on the sector. Prior to the Act the complexity and lack of consistency in legal services regulation lead to it being referred to as a maze¹⁵. Despite reform the regulation of this market remains unduly complicated and costly:

- 10 approved regulators, an oversight regulator and a statutory ombudsman scheme operate in a legal framework of at least 10 main statutes and over 30 statutory instruments, while trying to promote eight regulatory objectives;
- The front line regulators operate inconsistent codes of conduct and/or rule books, often running into hundreds of pages containing a bewildering mix of outcomes, behaviours, principles, rules, guidance and policies;
- Legally, only six “reserved legal activities” can only be undertaken by providers authorised and regulated by legal services regulators: most other areas of law can be provided without any regulation at all beyond general law;
- However, once a person is regulated (traditionally based on title such as “solicitor” or “barrister”) the unusual case, the highest risk, or the worst behaviour of any market participant is used to justify significant regulatory costs and prescription on a wide range of legal and non-legal activity.

19. This results in excessive regulatory burdens and costs driven by:

- **historical foundation of reserved legal activities combined with regulation by professional title** resulting in the regulatory protections for consumers and the burdens on businesses delivering legal services being determined by who provides the service and not the risks involved. These patterns of regulation were left largely untouched by the 2007 Act;
- **the culture and the practice of the front-line regulators** maintains a legacy of professional self-regulation centred on detailed rule books, that have never

¹⁵ Clementi D *Review of the Regulatory Framework for Legal Services in England and Wales Final report* (December 2004) at p2; The Department for Constitutional Affairs *The Future of Legal Services: Putting Consumers First* (October 2005) at p11; Abraham A *The Regulatory Maze Annual Report of the Legal Services Ombudsman 2001/02*

undergone a comprehensive review against the better regulation principles. These rule books still form the basis of new outcome based codes, where these have been developed;

- **fragmentation of regulation and remaining links to professions leading to requirement for oversight regulation** – the Act carried over the existing approved regulators along with their existing regulatory arrangements. Most are professional bodies, with a separate body within it now being responsible for regulation, rather than being fully independent¹⁶. This makes oversight necessary to dissipate the influence of vested interests and to maintain consistent minimum standards across the different arms of the profession;
- **the underpinning legislative authorities for the front-line regulators and their regulatory arrangements**, such as the Solicitors Act 1974, enshrines an emphasis on regulation of individuals with professional titles and existing core regulatory arrangements, hampering modernisation and market liberalisation.

20. The problems with this framework can be illustrated by considering the performance of the existing regulators, and the regulatory structure, against each of the principles of better regulation in turn¹⁷.

Proportionate?

21. The regulatory framework has developed organically over hundreds of years. “Reserved Legal Activities: History and Rationale” by the Legal Services Institute¹⁸ demonstrates that the reserved activities are an accident of history. Decisions about which activities are reserved have been made with no particular focus on risk, desired public interest or consumer protection outcomes or the potential benefits from a liberalised market.

22. Regulation for the majority of the legal services market is characterised by high entry barriers (in terms of education, time served, insurance requirements etc.) together with regulation of all activities undertaken whether those activities are reserved (and so considered by the Act to require regulation) or not. Any individual wishing to set up a will-writing firm can open up tomorrow. However, if they want to set up as a solicitors’ firm to offer will writing services they will need four years of education, two years as a trainee and three years in practice. One day to provide services outside of statutory regulation compared to nine years within regulation, very little of which is focused on the writing of wills. As demonstrated by LSB

¹⁶ The Master of the Faculties, who regulates the notarial profession, and the Council for Licensed Conveyancers have no representative functions

¹⁷ The principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed. See section 3(3) of the Act

¹⁸ Legal Services Institute *The Regulation of Legal Services: Reserved Legal Activities - History and Rationale* (August 2010)

http://www.legalservicesinstitute.org.uk/LSI/LSI_Papers/Discussion_Papers/Reserved_Legal_Activities_History_and_Rationale/

research into the will-writing market¹⁹, neither is satisfactory because neither protects the consumer. At one end of the spectrum high barriers to entry limit competition for solicitors making it more difficult to drive out poor performing and careless firms. At the other end non-solicitor firms can enter the market unchecked. There is evidence of too many providers selling products that are not needed, are unsuitable or offer poor value for money, acting beyond their competence and offering inadequate redress. Consumers of corporate law services tend to be well informed, repeat buyers who are well placed to discern quality in the service they receive. The reduced imbalance in knowledge between providers and consumers in this area greatly reduces a key rationale for the regulation of legal services²⁰. The regulation applied to corporate law providers could therefore also be considered disproportionate.

23. Furthermore, since the existing reserved legal activities and legislation such as the Solicitors Act 1974 were established, changes in consumer law have substantially enhanced protections available outside of those provided by legal services regulators. The draft Consumer Rights Bill is designed to improve and update consumer law further. It will set out a simple, modern framework of consumer rights. As these non-sector specific protections have been introduced, no assessment has been made to see how sector specific regulation can be reduced to avoid regulatory duplication (eg rules for solicitors' fees, which may no longer be needed given other statutory consumer protections and the greater powers of the Legal Ombudsman). In our view this is not a proportionate approach to the risks inherent in legal services.

24. In summary:

- disproportionate regulation has developed from traditional rule books, there have been some recent changes but they do not go far enough;
- entry barriers and an outdated reservation framework combine to leave significant gaps in consumer protection, which regulators tend to fill with disproportionate regulation;
- current and emerging consumer protection legislation is duplicated by sector-specific regulation.

Accountable?

25. Accountability of regulation is built into the current regulatory model in several ways. First, where the front-line regulator named in the Act is a professional body, regulatory functions must be separated from representative functions through delegation to an independent regulatory arm. Second, the LSB has an explicit role

¹⁹ See IFF Research *Understanding the consumer experience of will-writing services* http://www.legalservicesboard.org.uk/what_we_do/Research/Publications/pdf/lsb_will_writing_report_final.pdf

²⁰ Regulatory Policy Institute *Understanding the Economic Rationale for Legal Services Regulation* Report for the Legal Services Board prepared by Dr Christopher Decker & Professor George Yarrow (October 2010) at p28-30 <https://research.legalservicesboard.org.uk/wp-content/media/Why-regulate-legal-services-RPI-report.pdf>

in ensuring that the regulatory arms act independently of the associated professional bodies²¹. While initial (first tier) complaints are handled by firms subsequently they are handled by an independent ombudsman (for service complaints). The regulator will handle professional conduct complaints. Independent appeals for professional conduct issues are handled by a variety of independent tribunals.

26. The LSB also has an explicit role in assessing individual rule changes proposed by approved regulators. The process is set out in detail in Schedule 4 to the Act. The process is permissive in nature, which means that the grounds on which a rule change can be turned down are limited. We are not able to amend proposed changes, for example, to align more closely with the better regulation principles. Moreover, we have little power to require that entire rule books and cultural practices that were put in place in a different, pre-better regulation world are reviewed. The only option for doing so would be initiating difficult to use intervention directions.

27. Progress has been made in delivering the safeguards around independence envisaged by the Clementi review²². The LSB's annual assessments indicate that professional bodies have put in place governance structures that have the potential to deliver independent regulation. However, it is also noted that the potential for vested interests to have too great an influence on decision making by the regulator remains. For example, in relation to the Bar Council, the LSB concluded that over 2012/13 "our general observation is that the BSB has sought to maintain its independence from the Bar Council. However there have been incidents where the LSB has been concerned about the Bar Council's attempts to fetter this independence. We remain willing to take appropriate action if we find evidence of such issues"²³. The failure of the Act to push further and secure complete independence for regulators so they are not accountable to the profession has itself generated cost and complexity, distracting regulators and professional bodies alike from their core roles (see section 4).

28. Equally the accountability of the LSB, independent of both government and profession, is confused because of our status as a non-departmental public body (NDPB) linked to the Ministry of Justice (MOJ) rather than a Parliamentary body like the Professional Standards Authority (PSA). Independence from government is an important consideration for the rule of law and the international standing of the UK legal services sector.

²¹ In accordance with Section 30 of the Act the LSB has introduced rules setting out requirements for the purpose of ensuring that an approved regulator's regulatory functions are not prejudiced by its representative functions; and, so far as is reasonably practicable regulatory decisions are taken independently from decisions relating to the exercise of its regulatory functions.

²² Clementi D *Review of the Regulatory Framework for Legal Services in England and Wales Final report* (December 2004) <http://webarchive.nationalarchives.gov.uk/+http://www.legal-services-review.org.uk/content/report/index.htm>

²³ http://www.legalservicesboard.org.uk/Projects/pdf/bsb_regulatory_standards_final.pdf

29. In summary:

- there have been significant steps made to improve the accountability of regulators but much more remains to be done;
- full independence of regulation is needed to ensure freedom from vested interests and to remove need for oversight regulation;
- the oversight regulator's status as being independent of government is confused because of its NDPB status.

Consistent?

30. Consistency of regulation would be achieved if the same risks across legal services were subject to the same level of regulatory protection (where regulation is seen in its widest context including everything from general law, to professional norms and sector specific statutory regulation). The historical development of regulation, the variety of legislation underpinning different regulators and the complexity of the mix of reserved and non-reserved activities have not been systematically designed with a desire to achieve consistency in managing risks.
31. The regulatory protections and corresponding burdens on business are not derived from an analysis of risk but from the origins of the professions - a problem that wasn't addressed by the Act. The resulting regulation fails to achieve consistency either between different activities which pose the same risks or between the same activity carried out by different people. Even access to the Legal Ombudsman is based on the status of the provider rather than the consumer.
32. Further inconsistency is apparent in the regulatory arrangements applied by different regulators underpinned by different legislation, for example, standards of proof used by regulators and the different penalty imposing and enforcement powers that regulators have. Even within the same regulator, penalty powers differ. For example, the SRA acting as a licensing authority can impose penalties of up to £250m on an ABS entity and £50m on an individual, using the civil standard of proof. By way of contrast, when it is acting as an approved regulator for a traditional law firm it can only impose a penalty of £2,000; anything larger has to be decided by the Solicitors Disciplinary Tribunal, which uses the criminal standard of proof. Compensation and professional indemnity requirements also vary between regulators.
33. We recognise that there is likely to be a tension between the requirement for consistency and the requirement for targeting and proportionality. For example, we highlighted above that corporate law is subject to the same level of regulation as other areas that tend to relate to individual consumers, and as such is perhaps subject to over regulation. In this instance consistency is achieved at the expense of proportionality. In our view the current regulation of legal services has so many inconsistencies, whether in its approach to risk, appeals, redress, enforcement or financial protection that it is likely to result in both higher costs for firms and consumer detriment.

34. In summary:

- significant inconsistencies exist within and between regulators as a result of the statutory framework which are likely to lead to higher costs for firms and consumer detriment;
- there is a need to rationalise powers, particularly for enforcement and appeals;
- there is a need to guard against ‘disproportionate consistency’.

Transparent?

35. We have set out earlier in this section that regulation of legal services is complex structurally. As was the case before the Act, the framework remains a maze for consumers, providers, future providers and investors, as well as for regulators themselves.

36. Some regulators have made efforts to improve regulation by adopting outcomes focused codes and moving away from prescriptive rules. Nonetheless, complexity remains in the relationships between professional bodies and independent regulators. Complexity within regulatory arrangements also remains. For example, the client account requirements for solicitors remain prescriptive, detailed and reportedly difficult to understand. This can in part be explained by the fact that the outcomes focused codes were themselves largely based on the regulators’ previous complex rule-books.

37. More recent regulatory developments such as the process for authorisation as an ABS have demonstrated the pattern of regulators allowing some innovation, but with little transparency on their criteria for decision making. Examples of this are assessing business plans or waivers of the separate business rule. Until recently, demonstrating effective management of the performance of the ABS authorisation process would have been another example; as would the timeliness of that process. Although recent improvements have been made and others are on the way, the result has been a lack of market confidence and a suspicion that firms offering radically different services models face higher barriers.

38. Regulators have failed to embrace opportunities to increase transparency through publication of, for example, regulator performance data, costs, approach to claims for grants of compensation, cost benefit analysis and systematic policy evaluation, all of which could help to improve the transparency of regulation of legal services. There is almost no understanding of the opportunities offered by ‘big data’ in terms of risk management, regulatory design or consumer empowerment²⁴.

39. In summary:

- there is a maze of different protections and obligations depending on the type of provider and who, if anyone, regulates that provider;

²⁴ <https://www.gov.uk/government/publications/shakespeare-review-of-public-sector-information>

- legal services regulators currently operate in ways that are not transparent;
- transparency is made more difficult to achieve because of legislative and rule-book complexity.

Targeted?

40. As the Legal Services Institute demonstrated in its discussion paper, the reserved activities did not originate in an overarching assessment of the need for legal services regulation. There has been no consideration of the risks posed by legal services across the market to assess whether statutory sector specific regulation is more appropriate than other available protections.
41. There are areas in the regulators' codes that do demonstrate risk targeting – such as the protection of client money and more recently the development of the Quality Assurance Scheme for criminal Advocates (QASA). However, these examples sit within a much broader framework where regulation is not targeted at specific risks. As consultant regulatory economist Kyla Malcolm found in her recent research report on the proportionality of legal services regulation, there is “relatively little differentiation in regulation” between different segments of the legal services sector²⁵. However, risks vary significantly between the different segments (of legal activities, areas of law and types of consumer). Therefore, regulated providers in some segments of the market can face regulatory obligations and the associated costs to guard against potential risks across a range of activities in other segments of the market, which may be totally unrelated to the services those providers offer²⁶.
42. This lack of effective risk targeting can be used as justification for maintaining an excessively high minimum level of regulation. Gold-plating regulation in this way adds costs that are ultimately passed on to consumers. Lawyers' fees are a cost imposed on business transactions, and current regulation of corporate law is not accurately targeted at risk. While corporate consumers as repeat buyers are more able to discern quality than individuals and therefore may be in less need of protection, we highlighted above the risk posed to the public interest by corporate transactions (see paragraph 14). We consider that regulation of corporate services should be targeted at this risk, rather than the minimal risk to the consumer interest.
43. Keeping the costs of regulation down through liberalisation, accurate targeting and the removal of unnecessary regulation will help UK providers compete favourably with international providers for deals transacted in England and Wales. New models of legal services providers should offer SME businesses access to cheaper legal services that may help them to grow their businesses and reduce the management time spent on dealing with legal issues. This will help reinforce the

²⁵ Malcolm, K *Economics, Policy and Regulation, the proportionality of legal services regulation* (June 2013)

²⁶ For example, similar financial protection requirements apply irrespective of whether or not a provider handles client money.

UK's place as a global business centre and produce positive effects for the UK economy.

44. We therefore consider a more commercially aware approach could see significantly more targeting and a reduction in regulation. So while few would argue against a regulatory requirement to protect client money (ie over and above the fact that it is a criminal offence to steal other people's money), the rules themselves can be exceptionally complicated²⁷. This may result in some lawyers failing to understand them; with the undesirable - but probably predictable - result of a lower standard of consumer protection.

45. This analysis suggests the need for a renewed effort to identify exactly what risks in legal services require attention. Once these risks are identified it can then be decided which are best addressed through the use of sector specific statutory regulation and which can be handled by the broader regulatory environment.

46. In summary:

- there is some evidence of targeted regulation based on risk but gold plating is still prevalent;
- better risk profiling is needed to better target regulation and remove unnecessary sector specific regulation.

Other principles of best regulatory practice

47. It is essential that both the draft Regulators' Code²⁸ and the proposed duty on non-economic regulators to have regard to growth²⁹ are applied to all legal services regulators. The draft Code should help the regulators to focus on the needs of the businesses they regulate and provides a framework within which this can be done. It places particular emphasis on basing regulatory activities on an assessment of risk³⁰ and on transparency as well as the importance of clear information, guidance and advice. In the legal services market having a growth duty that complements regulators' other duties could have a significant impact on the economy.

²⁷ For example, the SRA Accounts Rules are 44 pages long, not including appendices. We would suggest these could be reduced to two outcomes: 1. Keep client money separate from yours/ your business' money; and 2. Protect client money from error, negligence, fraud, theft etc.

²⁸ Department for Business Innovation and Skills Better Regulation Delivery Office *Regulators Code* (July 2013) <http://www.bis.gov.uk/brdo/regulators-code>

²⁹ Department for Business Innovation and Skills Better Regulation Delivery Office *Government Response: Non-Economic Regulators Duty to have regard to Growth* (July 2013) <http://www.bis.gov.uk/assets/brdo/docs/publications-2013/13-1018-growth-consultation-response.pdf>

³⁰ On issues arising from risk based regulation see Black J, 'Choices, Practices and Lessons Being Learned' in *Risk and Regulatory Policy: Improving the Governance of Risk, Risk-based Regulation*, OECD, April 2010.

<http://www.oecd.org/gov/regulatory-policy/riskandregulatorypolicyimprovingthegovernanceofrisk.htm>

Conclusion

48. It is widely accepted that the patterns of regulation are no longer fit for purpose and are increasingly out of step with the principles of good regulation³¹. We hear many complaints. For example:

- consumer representatives highlight gaps in coverage for risky activities and confusion about the protections available between different providers delivering the same services;
- lawyers speak of regulation unnecessarily adding costs, and restricting their ability to innovate to better serve clients and maximise their competitiveness against different types of non-lawyer providers and law firms in other jurisdictions;
- some unregulated providers not doing reserved legal work argue that their inability to gain the badge of regulated status without lawyer staff makes it difficult to attract business because of a lack of consumer confidence;
- potential new entrants and investors report that regulatory complexity, uncertainty, as well as concerns over proportionality deter or delay them from entering and growing the UK market.

³¹ See, for example, responses to LSB consultation *Enhancing consumer protection, reducing regulatory restrictions*: http://www.legalservicesboard.org.uk/what_we_do/consultations/closed/pdf/6.pdf

4. Why independent regulation?

49. This section outlines:

- *Previous experience of self-regulation in the sector*
- *The problems resulting from a lack of full independence following the Act's reforms.*

Independence

50. A core tenet of the reforms to legal services regulation since the OFT's 2001 report "Competition in the Professions" has been the belief in the benefits of independent regulation. As noted earlier, the choice between self-regulation and independent regulation should not be considered a choice between regulatory burdens and no regulatory burdens. Whether rules by which market participants operate are developed and enforced by Government, independent regulators or professional bodies, they result in costs on market participants and so on consumers. In designing a regulatory system Government must consider who is best placed to minimise regulatory burdens while delivering the perceived benefits of regulation³².

Lessons from self-regulation

51. As Decker and Yarrow have shown³³, economists would regard it as inevitable that self-regulation will create higher regulatory barriers than is necessary to maintain quality in order to maximise the income of those practising, even if this action is subconscious.³⁴ Examples of these consequences were highlighted in the 2001 OFT report which considered the rules imposed by professional bodies (self-regulation) before the introduction of the Act, including price fixing and bans on advertising. A summary of the Decker and Yarrow report is included in annex A.

52. Even now, after the Act, the resistance from the legal profession to accountants and business advisors entering the market is a powerful drag on innovation, competition and consumer choice. This is perhaps not surprising given that self-regulation asks the profession to act as both rule setter and enforcer against itself³⁵. The response from Government was first to introduce measures of

³² On the potential benefits of risk-based regulation see, for example, Cousins D, *Improving the Implementation and Enforcement of Regulation*, Monash University: Centre for Regulatory studies 30 June 2011 OECD-Israel Workshop, p.6.

<http://www.oecd.org/gov/regulatory-policy/49090976.pdf>

³³ Regulatory Policy Institute *Understanding the Economic Rationale for Legal Services Regulation* Report for the Legal Services Board prepared by Dr Christopher Decker & Professor George Yarrow (October 2010) <https://research.legalservicesboard.org.uk/wp-content/media/Why-regulate-legal-services-RPI-report.pdf>

³⁴ Regulatory Policy Institute *Understanding the Economic Rationale for Legal Services Regulation* Report for the Legal Services Board prepared by Dr Christopher Decker & Professor George Yarrow (October 2010) <https://research.legalservicesboard.org.uk/wp-content/media/Why-regulate-legal-services-RPI-report.pdf>. In their analysis of the impact of self regulation Decker and Yarrow observed that "well-recognised problems can arise when the remit of self regulation moves beyond what is necessary to certify quality. In the limit, these can lead to some of the familiar adverse consequences associated with monopolisation and cartelisation."

³⁵ On the advantages and disadvantages of self regulation see Hepburn G, *Alternatives to traditional regulation*, OECD Paper, at p. 39-49, <http://www.oecd.org/gov/regulatory-policy/42245468.pdf>

oversight through its own infrastructure³⁶ then latterly the Act to push regulatory independence from the professions through ring-fenced regulatory arms with formal oversight from the LSB.

53. Independence continues to be regarded as an essential feature of high quality regulation. In legal services, further legislative changes could fully break the link between the profession and regulators. Whether to go further and significantly reduce regulatory complexity by reducing the number of regulators and/or remove the need for an independent oversight regulator would be another option. We discuss structural options in annex D³⁷.

Impact of the failure to deliver full independence

54. Despite the failure to take the opportunity presented by the legislative changes in 2007 to achieve full independence, significant improvements in regulation have been achieved, with further benefits still expected. However, the lack of full independence does result in a number of problems.

55. Firstly, and perhaps most obviously, there is a lack of clarity for the regulators on their objectives. To what extent should they be seeking to protect the reputation of the profession itself, and more particularly, their own part of it? While clearly the regulator has to follow all the regulatory objectives set out in the Act³⁸, the fact that regulators are attached to individual branches of the profession (rather than, for example, activities) and have a regulatory objective to encourage “an independent, strong, diverse and effective legal profession” can confuse the objectives of regulation. We showed in section 3 that there is very little targeting of regulation according to risk. A desire to protect and build the reputation of the profession may be part of the reason that regulators apply high regulatory burdens even in low risk areas.

56. A second problem occurs in relation to the transparency of the cost of regulation. A failure to achieve full separation leads to the professional and regulatory bodies sharing some costs, and the costs that should be collected from providers as optional professional membership being imposed as a compulsory regulatory levy. Removal of this compulsion could be achieved by changing the Act’s ‘permitted purposes’³⁹, which outline the permitted usage of money raised from practising fees, to include only the regulator’s costs and not the professional body’s representative costs. Our calculations illustrate that permitted purposes expenditure by professional bodies costs the legal services sector approximately

³⁶ For example, changes to qualification regulations or rules of conduct that related to the rights of audience or rights to conduct litigation were decided by the Secretary of State with assistance from the OFT and the Legal Consultative Panel

³⁷ For a general discussion of the advantages and disadvantages of self-regulation see Regulatory Policy Institute *Understanding the Economic Rationale for Legal Services Regulation* Report for the Legal Services Board prepared by Dr Christopher Decker & Professor George Yarrow (October 2010) at p59-62; Hepburn G, *Alternatives to traditional regulation*, OECD paper at p.34-49. <http://www.oecd.org/gov/regulatory-policy/42245468.pdf>.

³⁸ Section 1, Legal Services Act 2007

³⁹ Section 51(4), Legal Services Act 2007

between £20m and £25m per year⁴⁰. We consider that, as businesses, law firms should be able to choose whether to belong to a representative trade body based on their assessment of the benefits of membership. Legal services trade bodies should not receive preferential treatment⁴¹ compared to other sectors, such as insurance, banking or utilities, and should be able to attract membership based on their own merit⁴².

57. Finally, the lack of independence undermines the effectiveness of regulation by reducing its credibility. Where a regulator is seen to be an arm of the professional body that represents those regulated, consumers are bound to have less confidence in the fairness of regulation than with a regulator seen as fully independent. Independent regulation is therefore desirable to ensure that regulatory burdens are proportionate, targeted, transparent and credible.

⁴⁰ See *An analysis of the approved regulators' practising fees* at http://www.legalservicesboard.org.uk/Projects/statutory_decision_making/section_51_practising_fees.htm

⁴¹ ie. A guaranteed income

⁴² NB. This is already the case for some regulators such as IPReg

5. Independent oversight

58. This section outlines:

- *Why independent oversight is needed*
- *Ten of the LSB key functions, what they entail, what their objectives are, what came before the LSB and an analysis of success*

Why oversight is needed

59. If front line regulators are too closely tied or allied to the profession, independent oversight is required to ensure that particular or vested interests are not dressed up as the public interest. The need for oversight of legal regulation has long been recognised. Clementi described a system of 12 bodies overseeing different aspects of regulation of different parts of the profession. The LSB's oversight has rationalised this situation.

60. In a two tier regulatory system - meaning professional bodies plus regulators - oversight is needed to:

- guarantee independence of regulatory policy and decision-making from government;
- provide a similar guarantee of independence from professional bodies and other specific interests;
- in the current fragmented system, encourage as much consistency as possible while ensuring effective targeting of risk.

61. How effectively this is done depends on the precise functions given to the oversight body and the tools it has to discharge those functions.

Functions of the LSB

62. We have identified ten major functions of the LSB that would need to be present in any future regulatory structure, which are described in more detail below.

Function 1: regulatory independence

What does it entail?	What are its objectives?	What came before the LSB?
<ul style="list-style-type: none"> - Ensuring regulators are institutionally and culturally independent - Ensuring regulators develop and maintain independence from arms of the profession they regulate 	<ul style="list-style-type: none"> - Ensure regulatory decisions are not influenced by vested interests - Increase consumer confidence in profession - Modernise regulatory framework 	<ul style="list-style-type: none"> - Perceived lack of independence - Professional bodies also acted as regulators

Has it worked?

63. Structural separation of the representative and regulatory functions of the approved regulators has been achieved⁴³. The LSB oversees internal governance rules for the regulators, which set out requirements for independence and can be enforced by the LSB in the event of non-compliance. Cultural independence has proven harder to achieve, with many regulators remaining tied to their arm of the profession. The move to full independence is not helped by the language of the Act. A less than total commitment to independence is demonstrated in section 30, which only requires the exercise of an approved regulator's regulatory functions to 'so far as reasonably practicable' be taken independently from decisions relating to the exercise of its representative functions.

Function 2: regulator performance

What does it entail?	What are its objectives?	What came before the LSB?
<ul style="list-style-type: none"> - Facilitating self-assessments - Enforcement - Monitoring and investigation of rules in practice - Embedding regulatory objectives and better regulation principles 	<ul style="list-style-type: none"> - Public and consumer interest in high performing regulators - More targeted regulation enhances growth and innovation 	<ul style="list-style-type: none"> - Regulatory performance overseen by maze of oversight bodies each with narrow duties and limited powers - No statutory objectives - No obligation towards the better regulation principles

Has it worked?

64. The LSB has set the first independently established standards the regulators have ever had to consider in relation to performance⁴⁴. These are transparent and consistent across the regulators. The regulators have undertaken self-assessment and developed action plans for change.

65. However, the capacity and capability of some of the regulators is a barrier to their improved performance. A further barrier is the fact that the present system builds upon the old rule books of the regulators, which were 'passported' in without assessment against the better regulation principles.

⁴³ NB. Some arms of the professions do not have representative bodies, only a regulator

⁴⁴ http://www.legalservicesboard.org.uk/what_we_do/consultations/closed/pdf/20111214_regulatory_standards_v11.pdf

Function 3: rule approval

What does it entail?	What are its objectives?	What came before the LSB?
- LSB must consider applications for all changes to regulatory arrangements	- Ensuring rules are only changed in line with regulatory objectives and better regulation principles	- Complicated process involving Secretary of State, Legal Services Consultative Panel, OFT and four designated judges - Only some rules had to be approved

Has it worked?

66. The LSB has set itself key performance indicators in relation to the rule approval process and is increasing the use of its power to exempt a change from the full process⁴⁵. The process is now much quicker and more efficient than it was before the Act. The LSB is requiring rule changes by regulators to be evidence based and linked to clear objectives for the first time, and has facilitated the introduction of outcomes focused codes by both the SRA and the BSB.

67. A weakness of the current arrangements for rule approval is that they only apply to changes of specific rules. It cannot easily influence the overall regime of each regulator that sets the context for those rules. The LSB is also constrained by the Act from rejecting some rule change applications that it does not think appropriate. The wording in part 3 of schedule 4 states that the Board may only refuse rule change applications if it is satisfied that one or more of six conditions are met⁴⁶. This limits the refusals the LSB can make. An alternative wording, that the Board may only approve rule change applications if set conditions are met, would allow the Board more scope to filter out unsatisfactory rule changes.

Function 4: designation applications

What does it entail?	What are its objectives?	What came before the LSB?
- Considering applications from bodies wishing to be designated to regulate a reserved legal activity or become a licensing authority for ABS	- Ensuring only bodies capable of being effective licensing authorities or regulators are allowed to do so	- A body wishing to grant rights of audience or to conduct litigation had to apply to Secretary of State - ABS did not exist prior to Act

⁴⁵ http://www.legalservicesboard.org.uk/news_publications/publications/pdf/2013-14_business_plan_FINAL.pdf, p39-40

⁴⁶ Para 25(3), schedule 4 Legal Services Act 2007

Has it worked?

68. On the one hand there has been success. The LSB has overseen two bodies being successfully designated as licensing authorities. Between them, the SRA and Council for Licensed Conveyancers (CLC) have now authorised over 200 ABS⁴⁷. Delivery has been achieved well ahead of the time initially set out by government. In spite of this success the designation process remains cumbersome. The requirement for the MoJ to provide an additional layer of approval adds to the time taken for decisions. The need for statutory orders can also have an adverse effect on the decision timetable.

Function 5: practising fees

What does it entail?	What are its objectives?	What came before the LSB?
<ul style="list-style-type: none">- LSB published Practising Fee Rules⁴⁸ in 2009- Checking regulators have consulted with those affected about the anticipated fee- Checking money raised will only be used for Act's 'permitted purposes'	<ul style="list-style-type: none">- Proportionate practising fees, preventing unnecessary costs being passed to consumers- Transparency over revenue raised through practising fees	<ul style="list-style-type: none">- Measures ranged from approval by Master of the Rolls for solicitors, to no oversight for some other providers

Has it worked?

69. The LSB has established a clear process for approving the level of practising fees. Applications by the approved regulators are completed within four weeks of submission. There is now improved consultation with and increased transparency for regulated firms and individuals on how practising fees are used and the cost of regulation, although the LSB continues to push for further improvements. The permitted purposes⁴⁹ in the Act are broad and allow regulators flexibility to decide how they use the fees received. We have highlighted in section 9 that this compels authorised persons to contribute towards non-regulatory functions.

⁴⁷ 214 as of mid-august 2013

⁴⁸ See http://www.legalservicesboard.org.uk/what_we_do/regulation/pdf/practising_fee_rules.pdf

⁴⁹ Monies raised through practising fees must not be applied for any purpose other than one or more of the permitted purposes. See section 51 Legal Services Act 2007

Function 6: consistency of minimum standards

What does it entail?	What are its objectives?	What came before the LSB?
- Ensuring regulators set equivalent minimum standards in relation to the regulatory objectives	- Same minimum standards of quality and service for consumers - Parity in regulatory burden across providers	- No single source of oversight - 2005 Government white paper described a maze of 12 sources of oversight

Has it worked?

70. Each of the regulators is required to act in a way that is compatible with the regulatory objectives⁵⁰. To assist with this the LSB has published a guide on how we interpret those objectives⁵¹. This acts as a reference point for consistency across the different arms of the profession.

71. The main tool available to the LSB in this area is the rule approval process, so our powers to push for consistency are limited. We are unable to call in rules for review against the better regulation principles, and have to wait for a specific rule change application to be lodged to be able to conduct any assessment. However, some progress has been made by regulators in focusing more on outcomes.

Function 7: complaints resolution and access to redress

What does it entail?	What are its objectives?	What came before the LSB?
- Ensuring regulators require providers to have complaints procedures - Establishing the OLC to provide route to independent redress for justified complaints - Appointing the OLC and approving its budget, reviewing its performance and requiring/setting targets if needed - Consenting to scheme rules	- Consumer interest in prompt and fair resolution of complaints	- OLC did not exist prior to Act – each professional body dealt with its own complaints - Performance of Law Society's in resolving consumer complaints over past years was key driver for reforms

⁵⁰ Section 28 Legal Services Act 2007

⁵¹ Legal Services Board *The Regulatory Objectives* (2010)

http://www.legalservicesboard.org.uk/news_publications/publications/pdf/regulatory_objectives.pdf

Has it worked?

72. The LSB requires all approved regulators to ensure that those they regulate make it clear to consumers that they have the right to complain about their provider, how to make a complaint and to whom this can be done (“signposting requirements”). The LSB has also delivered the Act’s requirement that an OLC be established to administer an independent Ombudsman scheme to resolve complaints from consumers dissatisfied by the service received from their provider. Now resolving around 7500 complaints a year, the OLC has reduced its budget year on year since opening its doors. However, the OLC still faces challenges in lowering unit costs and access to redress is uneven, covering only services delivered by regulated legal services providers (see section 8).

Function 8: regulation, education and training

What does it entail?	What are its objectives?	What came before the LSB?
- Section 4 duty to assist with standards of regulation, and in education and training of authorised persons	- Regulation compliant with better regulation principles and regulatory objectives - Suitably trained providers	- We are unaware of any equivalent duty on any of the oversight regulators in place before the Act

Has it worked?

73. The push by the LSB for review of legal education and training lead to the Legal Education and Training Review, which was commissioned by the SRA, the BSB and ILEX Professional Standards. The lack of progress prior to the intervention of the LSB highlights the difficulties that arise in areas where collaboration by the regulators is required. We are now considering the need for section 162 statutory guidance in this area in light of the initial views expressed by the regulators on the way forward. If adopted, statutory guidance would enable us to take a more proactive approach while still allowing regulators the appropriate flexibility.

Function 9: regulatory conflict

What does it entail?	What are its objectives?	What came before the LSB?
- s53 provides for regulators to apply to LSB to resolve conflicts between them - s54 power of LSB to act to resolve external conflict	- Regulators not distracted from delivery of regulation compatible with the regulatory objectives and the principles of better regulation	- Despite the 12 oversight bodies Clementi identified, there was no single body to resolve regulatory conflict prior

		to LSB - Less potential for conflict pre-ABS, with regulation focused on individual titles rather than entities and limited cross-discipline working by different branches of the legal profession (see section 10)
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Has it worked?

74. So far there have been no requests for the LSB to use their section 54 power. The possibility for regulatory conflict is one of the criteria that have to be considered as part of each rule change and designation application.

Function 10: policy development

What does it entail?	What are its objectives?	What came before the LSB?
- Consideration of what should be regulated, in order to better comply with s23 duty relating to the regulatory objectives	- Policy work aims to understand the market more fully and assess the need for change	- Prior to the Act regulation developed piecemeal, with no common rationale for the legislation governing the market

Has it worked?

75. The LSB continues to push for greater liberalisation but is constrained by the mechanisms for change provided by the Act. The priorities for our strategy development and research work that were outlined in our business plan for 2013/14⁵² related to developing a changing workforce for a changing market; putting consumer interests at the heart of regulation; investigating the cost and complexity of regulation; and further developing a robust evidence base to inform our regulatory decisions. We consider that these priorities will continue to bring improvements within the sector.

⁵² Legal Services Board *Business Plan 2013/14* (April 2013)
http://www.legalservicesboard.org.uk/news_publications/publications/pdf/2013-14_business_plan_FINAL.pdf

6. Reforming regulation, reducing burdens

76. This section outlines:

- *The need to target regulation on risks*
- *Three key areas of risk: the public interest; the consumer interest in quality of service; and the consumer interest in the protection of client money*
- *The regulatory tool-kit that can be used flexibly by regulators*
- *The appropriate use of tools to address identified risks*
- *The need to accept the limitations of regulation*

Targeted regulation

77. In sections 3 and 4 we have illustrated the problems we see with the current model of legal services regulation. In this section we start to illustrate how a greater focus on risk could help reduce regulatory burdens and so allow the development of a more competitive, innovative legal sector.

78. In our view the need to target regulation ruthlessly is key to reducing regulatory burdens while ensuring the objectives of regulation are delivered⁵³. To help target regulation at key risks we have grouped the risks into three areas:

- Public interest in the effective administration of justice and confidence in the law and legal service providers - society funds both the courts and legal infrastructure. There is a public interest in the fair and effective administration of justice to underpin the rule of law and legal rights of citizens;
- Quality and appropriateness of advice and services - legal advice is often related to the loss of liberty or significant personal or financial loss making the quality of advice received hugely important to consumers of legal services and affected third parties; and
- Client money - some elements of transactional law⁵⁴ rely specifically on the public having confidence in the safety of money placed with lawyers.

79. To target regulation effectively regulators must first identify the activities or services that lead to risks in these three areas. Next, all the potential ways of addressing these risks should be considered, whether by general law, professional standards or sector specific statutory regulation. Finally, all unnecessary existing regulation should be removed where it is either unwarranted, given the risks identified, or the objectives are better delivered with alternative tools. This could dramatically improve the effectiveness of regulation, reduce burdens on businesses and increase access to legal services with regulatory protections for consumers.

80. In particular we propose that:

⁵³ On proportionate and risk based regulation in relation to enforcement see OECD, *Public Consultation on best practice principles for improving regulatory enforcement and inspections; Draft report submitted to the public for comments*. August 2013 at p12-13.

⁵⁴ For example, conveyancing

- regulators should focus on risks to the public and consumer interests to help identify risks that may require additional protections;
- all legal services supplied should allow consumers access to LeO or another alternative dispute resolution (ADR) service,
- regulations should be largely concentrated on entities rather than named individuals;
- only in exceptional circumstances where risk is deemed particularly high, such as where a client's liberty or life is at risk or there is risk of other life changing personal or financial consequences, should regulations be placed by sector specific regulators on individuals offering legal services (rather than the entities placing requirements on the individuals they employ).

Risk segmentation

81. Risks are present throughout society in all the activities we undertake in our lives. Consumer law, including criminal law, supports our rights and allows us to manage risk. These are supported by consumer awareness campaigns and voluntary, industry led quality marks and accreditation in some cases. In some other areas of the economy (eg gas installation) sector specific regulations are introduced to protect consumers but without sector specific regulators to oversee and enforce them.
82. Only in exceptional circumstances are risks considered so high that additional protections are deemed necessary through sector specific statutory regulators, for example where there are natural monopolies or specific societal risks (eg in financial services).
83. To ensure that regulation meets principles of good regulation it is essential to understand what exactly the risks are that make a statutory sector specific regulator necessary in legal services.
84. We consider that the challenge with the current regulatory arrangements is not so much that the risks identified within the current structure of legal regulation are wrong, simply that the regulation fails to consider all options for addressing the risks and fails to tailor solutions to the differing levels of risk identified. Not every risk calls for regulatory action. While it is important to design regulatory protections for consumers which are targeted and can help in mitigating identified risk areas, regulators also need to be alive to the issue of unintended consequences: if "better" consumer protection actually leads to higher costs or less innovation, then regulation can actually disadvantage consumers and providers alike.
85. As illustrated in section 2 the Oxera framework can provide a useful tool in analysing the location of the risks, segmenting by client type, client need and type of legal service provided. While we do not suggest that in the time available we have segmented the risk for the whole legal market, a simple analysis can identify areas that are relatively high or relatively low risk. In areas of relatively high risk

regulators can analyse whether existing protections are sufficient, while in low risk areas protections can be removed.

86. Key to this analysis is considering all of the potential tools available - from a reliance on consumer information, properly enforced general law, professional ethics and industry codes, to Ombudsman schemes and finally sector specific statutory regulation.

Matching tools to risks

87. There is a range of preventative (before service), ongoing and remedial (after service) tools available to regulators. Choosing appropriate tools will depend on the level and cause of risk, with different types of risk being best addressed by different tools. The range of tools available is outlined in Figure 1 below.

Figure 1: Regulatory tool-kit

Regulatory tool-kit	
Before the event	Education and training (general/specific/practical/academic) Fit and proper tests (character and suitability, outside interests) Personal responsibility (Head of Legal Practice, Head of Finance Administration etc) Systems and internal processes Consumer information
Ongoing	Education and training (CPD etc) Operation of systems and internal processes Financial protections Insurance Quality indicators to help consumer choice Maintaining provider registers Codes/outcomes/rules Risk profiling, monitoring and supervision Culture, ethics, vales
After service	<i>Redress</i> In-house complaints procedures Legal Ombudsman Insurance Compensation arrangements <i>Compliance and enforcement</i> Investigation Informal resolution Censure Supervision Intervention Fine Practice restrictions Exclusion Prosecution/refer to criminal justice system

88. Preventative tools are designed to offer before the event assurance that the provider is competent and committed to maintaining specified standards. At its most extreme this means controlling entry and may also include, for example,

setting conduct and practice codes and other ongoing requirements as conditions of practice.

89. The use of ongoing requirements such as risk profiling and corresponding supervision is designed to manage risks and reduce the chance of resulting detriment.
90. Remedial tools such as provisions to allow simple, low-cost complaints and compensation for consumers, as well as disciplinary and enforcement regimes, are designed to provide remedy when things go wrong because of the shortcomings of the provider. Deciding the appropriate mix of preventative and remedial tools will be a matter for the particular circumstances, depending on types of clients, risks of the activities and costs and impacts of any intervention. For example, in circumstances where clients are vulnerable and the impact of a poor outcome irreversible (eg a prison sentence) regulation would favour preventative action. Equally, in circumstances where clients are well informed and the impacts of poor outcomes are reversible (eg through financial compensation), regulation may favour remedial measures.
91. Section 21 of the Act lists all the different types of rules or regulations that could fall within the definition of 'regulatory arrangements'⁵⁵. Regulators have a tendency to view this list as describing all the tools they should always be using, rather than as a list of possible tools that are available to them if appropriate. This attitude is unsurprising considering that the historical basis of the list in section 21 was the existing rule books of professional bodies in place before the Act⁵⁶. In practice regulators should take wider market, cultural and economic developments more into consideration when setting their regulatory arrangements. A clear example of this has been the lack of response by the regulators to the progression of consumer law and the protections it offers, which could replace some existing consumer protections within regulatory arrangements.
92. Even if a risk and an appropriate tool are identified, intervention is still not necessarily the correct path. Cost benefit analysis is needed to test proposed regulatory interventions, but the benefits of interventions are difficult to measure so often the cost benefit analysis remains inconclusive. Subsequently there is a need to reconsider regulation after it is introduced to see whether the expected benefits have been produced. There are few practical examples where analysis has been undertaken after the introduction of regulation. For example, do existing CPD

⁵⁵ These are (a)its arrangements for authorising persons to carry on reserved legal activities, (b)its arrangements for authorising persons to provide immigration advice or immigration services, (c)its practice rules, (d)its conduct rules, (e)its disciplinary arrangements in relation to regulated persons (including its discipline rules), (f)its qualification regulations, (g)its indemnification arrangements, (h)its compensation arrangements, (i)any of its other rules or regulations and any other arrangements that apply to or in relation to regulated persons, and (j)its licensing rules

⁵⁶ Given statutory basis through successive legislation, see the LSB discussion document *Enhancing consumer protection, reducing regulatory restrictions*, at p.25-26 for further detail:

http://www.legalservicesboard.org.uk/what_we_do/consultations/open/pdf/enhancing_consumer_protection_reducing_restrictions_final_28072011x.pdf

requirements in terms of hours unrelated to areas of practice or specific performance feedback provide any benefit in raising the quality of advice delivered? A general lack of counterfactual evidence has proven a barrier against applying the same cost benefit tests to existing regulation.

93. A considered review of the cost and complexity of regulation undertaken by fully independent regulators would provide an opportunity to assess again which tools are appropriate given actual risks.

Accepting the limitations of regulation

94. We suspect that the overall level of regulation introduced by regulators, if subjected to cost benefit analysis, would prove too high. In part this reflects the fact that regulation operated in practice rarely works as effectively as might be imagined when it was developed by policy-makers. This is reflected in the recent Better Regulation Framework Manual⁵⁷ where costs and benefits were expected to demonstrate that “the regulatory approach is superior by a clear margin to alternative, self-regulatory or non-regulatory approaches.” As noted in section 2, we should be as tough on the need for an effective and realistic assessment of self-regulatory approaches as on statutory sector specific regulation as both lead to regulatory burdens. Accepting a higher bar for introducing regulation would suggest that many of the tools which have previously been justified, in theory, as tackling identified risks are in practice unnecessary.

95. Analysing existing regulation in this critical way and looking to reduce regulatory burdens (eg for large business clients), would require regulators being willing to accept greater risk. However, the reward could be significantly reduced regulatory burdens, lower costs, greater innovation and economic growth.

96. We do not suggest that we know all the answers, but our examples illustrate the potential reductions in regulation possible from a complete rethink of the use of regulation in legal services. We maintain that it would be possible to significantly reduce the reach of statutory regulation by relying more heavily on consumer and criminal law. A resulting liberalised regime with lower regulatory barriers could deliver competitive benefits, stimulate innovation and allow England and Wales to grow as an international centre of legal expertise backed by effective regulation.

⁵⁷ Department for Business Innovation and Skills *Better Regulation Framework Manual Practical Guidance for UK Government Officials* (July 2013)
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/211981/bis-13-1038-better-regulation-framework-manual-guidance-for-officials.pdf

7. Regulating legal services by risk

98. This section outlines:

- *A different approach to that centred on the reserved legal activities*
 - *All legal activities would be subject to a common baseline of protections consisting of access to an Ombudsman or other ADR plus existing and new consumer and criminal law*
 - *Only above this, a risk based model of regulation*
- *Obstacles for the existing regulators*
- *Proposals to work towards this new framework*

Outcome

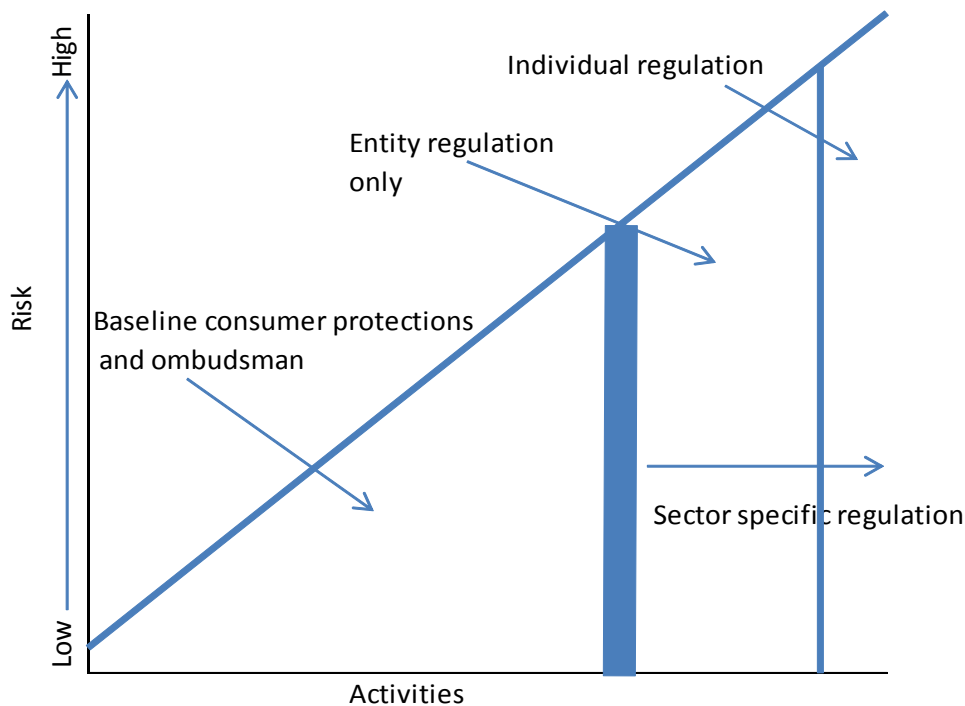
99. It is our view that there is a need for a comprehensive review to consider on a risk basis which activities within legal services require sector specific regulation and what form that regulation should take. This should focus on a new model of regulation that uses the regulatory tools flexibly to target risk in the least restrictive way possible.

Our suggested approach

100. At the heart of our proposed approach to regulation is a belief in the need for regulation to be closely targeted at the risks outlined in section 6. The model we outline below can achieve this and significantly reduce unnecessary regulatory burdens. In particular we propose a model (see fig.2) where:

- there is a baseline protection for all legal activities based on the availability of redress;
- legal services specific regulation is targeted at entities for the majority of activities;
- where specific high risks are identified which can be addressed by tests of individual competence and personal accountability, regulation will be applied to individuals.

Figure 2: Approach to regulation by risk



Baseline protection

101. Instead of the existing reserved activities, we would like to see a baseline of minimum protection for all legal services – the availability of LeO or other ADR for all individuals and small businesses, sitting above the range of protections offered by existing consumer law (including the new Consumer Bill of Rights) and criminal law. This would allow the removal of much of the existing duplication of regulation across a range of legal activities. This approach would be aligned with transposition of EU requirements designed to ensure the availability of ADR across all consumer services.

102. Above this, a consistent framework of protections for all consumers of legal services regulations would be kept, targeted either at entities or individuals depending on the assessed level of risk. This additional regulation, beyond the baseline protection of consumer and criminal law and ADR, would only be imposed where clear risks were identified and appropriate tools available.

103. This approach will open up the market to greater competition and will remove the barrier that regulation presents to innovation.

Entity focused regulation

104. Historically, legal services regulation has focused on individual lawyers. The Act provides that authorisation attaches to a regulated entity⁵⁸ and not just the individual. Section 15 of the Act provides that entities can also be authorised by regulators to carry out reserved legal activities. In his report on legal services regulation Sir David Clementi said that “the change in regulatory emphasis proposed in this review is a shift in emphasis towards regulation of the economic unit and away from regulation of individual lawyers⁵⁹”. It is our view that future regulation should have an even greater focus on the entity and less on the individual.

105. Within this model, entities would be free to determine the most appropriate people to undertake and supervise different types of work based on the knowledge, skills, competence and experience needed to achieve the right outcome. There will be further considerations of how best to ensure that appropriate behaviours and ethics in line with the professional principles are adhered to throughout the workforce. Often this should be possible through conditions of employment and the culture set by the entity - its owners, and senior staff.

Individual regulation

106. Policy makers and regulators will therefore face the challenge of deciding when to restrict activities to individual practitioners. For certain activities, where the approved regulator has established that greater before the event quality assurance is needed, appropriately qualified individuals within the entity would have to be authorised to undertake certain work. We think that this should be limited to higher risk work, where there is a particular need for this restriction.

Issues to consider

107. A number of challenges exist with this approach:

- the difficulty of defining the scope of legal activities to be covered by the ADR mechanism;
- the need to identify high risk areas;
- the need to safeguard against future regulatory creep.

108. As the scope of regulation shrank, it is possible such a model could provide scope for consolidation among the existing regulators.

Identifying risk in legal services

109. Identifying risk is not simple, a number of aspects: activities; areas of law; consumer types; public interest/rule of law; and sector specific risks are considered

⁵⁸ Section 18(1)(a) of the Act provides that an “authorised person” includes, inter alia, a person who is authorised to carry on the relevant activity by a relevant approved regulator. “Person” is defined in LSA s207 and “includes a body of persons (corporate or unincorporated)”

⁵⁹ Clementi D, *Review of the Regulatory Framework for Legal Services in England and Wales Final Report* (December 2004) at para 12

below. There has not been opportunity within the timeframe of this call for evidence to undertake a full and evidence based review of risks across the different segments and markets identified by Oxera in their framework to monitor the legal services sector⁶⁰. However, it is possible to undertake a principles based analysis of which legal activities are likely to be higher or lower risk based on the three primary risk categories set out in section 6.

Legal activities

110. We think that litigation and advocacy are likely to be the highest risk legal activities. This is on public interest grounds and because of the potentially severe consequences for consumers resulting from poor quality services. This is especially so given that these activities facilitate dispute resolution, including between the citizen and the state.

111. Good quality litigation and advocacy services contribute towards delivering the following outcomes:

- just, reliable and consistent decisions;
- the effective administration of justice;
- smooth and efficient functioning of the court system;
- public and business confidence in the rule of law, the legal system and the legal services providers (promoting both citizens' ability to enforce their rights and England and Wales as a global legal centre for business).

112. Therefore, statutory sector specific regulation is most likely to be required for these activities, certainly in the higher courts and in high risk areas of law where the outcome can impact on life, liberty, or result in other life changing financial or personal consequences. Specialist knowledge, skills and personal accountability are often required. It is likely that before the event assurance will be proportionate, with exclusive rights granted to individual practitioners.

113. We think that most legal research and document production, and a large proportion of advice (particularly in relation to transactional or consumer matters), are likely to be included within the lowest risk legal activities. Poor quality services are less likely to result in significant detriment. An emphasis on remedial tools is most likely to be proportionate, with greater emphasis on alternatives to sector specific statutory regulation. There may be exceptions; for example, in instances where information asymmetry is greatest, consumers are most vulnerable and where the eventual outcome may have particularly significant or irreversible consequences.

⁶⁰ Oxera Consulting Ltd, *A Framework to Monitor the Legal Services Sector* (September 2011) <https://research.legalservicesboard.org.uk/wp-content/media/A-framework-to-monitor-the-legal-services-sector.pdf>. For a summary of Oxera's framework see the LSB research website at <https://research.legalservicesboard.org.uk/wp-content/media/Summary-Oxera-June-12.pdf>

114. There are further activities where consumer, public and business confidence in the quality of execution underpin the administration of justice and business transactions. These include notarial activities, administering oaths, transferring deeds and the ability to rely on conveyancers' undertakings in relation to property transfer. The absence of such confidence would likely result in a reduction in trade causing significant economic impacts. Therefore, some sector specific before the event assurances may be proportionate but it is not immediately clear which tools from the regulatory toolbox would most proportionally target the risks.

Areas of law

115. Level of risk and potential protections needed may vary for the same activity in different areas of law. For example, greater protections may be needed in relation to areas such as crime, immigration/asylum, family (ie disputes with such a serious impact on children that the state has to intervene) and mental health. Consumers may be particularly vulnerable. Moreover, the impact of unjust decisions could be particularly severe. Consideration as to whether regulatory intervention targeted at prevention and ongoing mitigation is likely to be appropriate. Remediation is unlikely to be a sufficient response to imprisonment, deportation, children being taken into care or detention on mental health grounds. There are particular risks in areas where holding large amounts of client money is involved such as conveyancing and estate administration.

116. The tools needed to protect against loss of client money are very different to those needed to protect against risks around the quality of advice provided. The nature of service in other areas may present different risks requiring different protections. For example, will-writing, because problems are often not spotted until after death⁶¹.

Consumer type

117. Individuals and SMEs are the consumer groups at highest risk. This is because they are more likely to be infrequent purchasers and less able to judge the quality, value and appropriateness of services purchased. They are likely to purchase legal services less frequently and with a lower budget than large firms, reducing their ability to individually influence the price and service provided. They are also less likely to have the confidence or funds to pursue redress through the courts if they receive a poor quality or inappropriate service.

118. Any future review of legal regulation may also consider whether and how the need arises for statutory sector specific regulatory protection for larger commercial consumers. Corporations often employ in-house lawyers who purchase their external legal services. These in-house consumers will be informed, repeat purchasers who are better able to negotiate price and monitor service quality. This reduces or removes one of the main economic rationales for regulation and suggests a much reduced level of regulation is likely to be proportionate. However,

⁶¹ http://www.legalservicesboard.org.uk/Projects/pdf/20130131_will_writing_ia.pdf

as set out in section 2, there are public interest risks from activities in the corporate market particularly as corporate lawyers assist in large scale financial transactions, which can have implications for the wider economy.

Sector specific regulation

119. There will be further regulatory choices to be made about the shape of regulation. For example, practice and conduct codes may include outcomes, rules or both and there may be different approaches to monitoring, supervision and enforcement⁶² in different situations. We have argued that in most cases regulation would be better targeting outcomes for consumers, the public etc. rather than using rules that target inputs⁶³. This allows the provider to structure the business more efficiently, minimising any propensity for gold-plating of inputs while ensuring the necessary identified protections are delivered. To some extent this is already happening, with some approved regulators moving towards outcomes and risk based regulation⁶⁴. There is, of course, nothing to stop providers, with the assistance of their professional bodies, from setting higher standards for themselves to stand out in a crowded market. However, the argument of this paper is that present arrangements militate against further progress rather than setting the right incentives for further simplification.

⁶² On enforcement and best practice see OECD *Public Consultation on best practice principles for improving regulatory enforcement and inspections; Draft report submitted to the public for comments*, August 2013

⁶³ See Legal Services Board, *Developing Regulatory Standards* (April 2011) http://www.legalservicesboard.org.uk/news_publications/latest_news/pdf/21110420_developing_reg_std_finalrb_proof_3.pdf

⁶⁴ See for example the SRA handbook available at <http://www.sra.org.uk/handbook/> and the Council for Licensed Conveyancers (CLC) handbook available at http://www.clc-uk.org/pdf_files/Handbooks/2011_CLC_Handbook.pdf

8. More comprehensive redress, less regulation

121. This chapter sets out proposals for:

- *Broadening consumers' right of access to redress for all legal services*
- *Developing the role of the OLC to enable it to play this enhanced role*
- *Breaking the link between redress and regulation to ensure that these additional consumer rights do not generate unnecessary further cost for firms*

The starting point

122. Dissatisfaction with complaints handling within the legal services market was one of the key drivers of the entire regulatory reform process. Prior to the Act, consumer complaints about legal services, which were not being resolved satisfactorily by the provider, were investigated by the self-regulatory professional bodies. If consumers were dissatisfied with the outcome of those investigations, complaints about improper, ineffective or inefficient complaint handling could be made to the Legal Services Ombudsman, a statutory officer. For complaints about solicitors only, the statutory framework also include the Legal Services Complaints Commissioner (LSCC), who had powers to require the Law Society to report on their complaints handling, to investigate their complaints handling, to make recommendations and set targets and to require action plans for improvements. Ultimately, the LSCC could impose a financial penalty of up to £1million or 1% of the Society's income if a plan failed to be submitted or complaints were handled inadequately.

123. That system was widely regarded as having failed for a variety of reasons:

- despite a variety of organisational changes over many years, turnaround times for handling second tier complaints, even on relatively trivial matters, were poor with cases often taking well over 12 months to resolve. This was a particular issue for complaints about solicitors handled by the Legal Complaints Service, where good performance in its final two years of operation could not undo the reputational damage of slow service in its earlier years;
- the system did not effectively differentiate the two tasks of providing redress for the consumer of services on the one hand and determining whether a practitioner had committed a regulatory breach on the other. The result was a delay in remedies for consumers and a defensive attitude from the profession which could perceive a degree of regulatory threat in any complaint;
- the extended nature of the process and its three fold nature encouraged constant appeals which added further delay;
- the fact that the process was perceived as under the control of the profession, despite steps to strengthen independent governance, fatally undermined its credibility with many audiences.

The current position

124. The advent of the OLC has made a material improvement to this situation. Unlike the previous machinery, there is

- a clear differentiation between disciplinary and redress matters, with the results that consumers can receive a remedy quickly
- the ability of an Ombudsman to impose a settlement binding on a firm, but not the individual, helps to expedite the final resolution of a case
- the fact that the OLC is clearly independent of the profession at an institutional level removes past concerns about an absence of impartiality.

125. This improved legislative framework is already starting to pay dividends for consumers and industry alike. In particular, LeO has:

- consistently resolved at least 50% of cases within three months
- started to be more proactive in feeding back lessons from its work to the sector, including publications on costs and divorce issues
- operated at a consistently lower cost than the predecessor bodies which it replaced and continued to make significant budgetary reductions in each year of its operation.

126. Most importantly, there is some evidence that the very existence of the Legal Ombudsman is helping to raise standards of first tier complaints handling by legal services providers. In the period 2011/12 to 2012/13, the number of complaints made to solicitors fell by 2% or by 500 in absolute numbers. This is a surprising finding at a time of austerity when incentives to complain might be expected to rise and reflects well on the professionalism of the industry. At the same time complaints referred to LeO for resolution fell by 15%. LeO has, however, handled some 3,975 complaints, or 40% fewer than its predecessor bodies, in 2012/13. Although some of that fall may be due to lack of “brand recognition” of the Legal Ombudsman as a comparatively new body and some due potentially to poor signposting by some parts of the industry, it seems probable that at least part of the fall is due to the very fact of the existence of an Ombudsman with the power to impose a settlement leading more firms to “get it right first time”.

Problems with the current framework

127. However, this comparative success does not mean that the current arrangements are unproblematic. The framework for consumer redress, just like the framework for regulation as a whole, continues to lag developments in the market-place.

128. Some of this is a matter of pure bureaucratic complexity. The OLC was established by the Act⁶⁵ to set up and maintain an Ombudsman scheme, and is responsible for appointing the Chief Ombudsman. Although it is operationally

⁶⁵ The Act addresses complaints and the OLC in parts 6 and 7 and schedule 15.

independent, the OLC has a complicated relationship with MoJ and the LSB. The LSB has a range of duties in relation to the OLC including appointing and remunerating the OLC Chair and Members, and approving their budget and scheme rules. The OLC is also accountable to Parliament through the Lord Chancellor and is sponsored by the MoJ. The Lord Chancellor's duties in relation to the OLC include approval of the LSB's decision on the appointment of the Chair, consenting to the case fee structure and considering any recommendations made to him or her. Although simpler than what it replaced, it is hardly a model of effective organisational design.

129. However, the key issue is that consumer access to redress is uneven. The Legal Ombudsman can consider complaints in relation to all legal services provided by "authorised persons", ie people or entities who are regulated to do one of the six reserved legal activities under the terms of the 2007 Act. In the past, that provision would have effectively enabled access to redress for virtually all legal service disputes. However, this is increasingly not the case as new entrants offer services in unreserved areas, notably but not exclusively will-writing, and other firms consider whether to offer exclusively non-reserved services as business models become more specialist.

130. This presents a highly unsatisfactory situation, with an adverse impact on many of the regulatory objectives set out in the Act:

- consumers can find themselves materially disadvantaged if they make purchases in the belief that redress will be available, only to find that that is not the case;
- competition can be depressed if consumers choose to avoid innovative providers because of a lack of trust, caused in part by the absence of redress mechanisms;
- firms can find themselves facing disproportionate burdens if, in order to provide access to redress via the Legal Ombudsman, they have to alter their business models to provide reserved activities and so face the full weight of regulatory costs. Rather than enabling redress, regulation is, paradoxically, acting as an obstacle to its effective implementation.

131. This unevenness of treatment and resulting impact on public trust and confidence is ultimately something which could undermine public trust and hence be inimical to the wider public interest and the rule of law.

132. The EU directive on consumer ADR⁶⁶ requires the UK to make ADR available by 2015 for all complaints by consumers against traders, including those who provide professional services, under most contracts for services and goods. The question

⁶⁶ Directive 2013/11/EU on alternative dispute resolution for consumer disputes and amending Regulation (EC) No 2006/2004 and Directive 2009/22/EC

for the OLC is how far they should seek to provide ADR for the legal services that LeO does not currently cover and for other professional services as well.

133. However, the provisions in the Act to enable the OLC to offer voluntary schemes are adequate neither to address the fundamental issues of uneven consumer access to redress nor to enable it to make a wider service offering. There is no commercial incentive on a provider, currently under no obligation to offer redress, to incur a level of cost in a voluntary scheme if a similar obligation is not placed on all their competitors.

134. The LSB's conclusion therefore is that the right to access to redress via LeO should be comprehensive across all legal services and should not, as at present, be tied to the regulatory status of the service provided and/or the organisation providing it.

135. Effectively, this conclusion is no more than a sector specific justification for the conclusion which has been reached already in relation to the ADR Directive, the transposition of which Government is considering. Implementation of that Directive may offer a way of making faster progress on this nexus of issues than awaiting major legislative change on the regulatory framework as a whole.

A new mandate for the OLC

136. If it is to discharge this larger role, it is far from clear that the current organisational framework for the OLC is the right one. In particular:

- the primary legislation governing its operations is far more detailed than for comparable schemes – some 60 sections of legislation, compared to 12 for the Financial Ombudsman Service to take one example;
- it is far from clear that its status as a public body needing to comply with Government accounting rules and Ministry of Justice approval mechanics, (even though it derives its income wholly from the sector rather than taxation), enables it to be sufficiently fleet of foot in making and implementing investment decisions and deploying its resources and expertise in other sectors;
- the position is further complicated by the complex three-way relationship between OLC, LSB and MoJ, which confuses accountability for the organisation and adds a significant level of avoidable complexity to process such as agreement of the annual budget.

137. The LSB therefore recommends that a study is launched, in the context of implementation of the ADR directive, with a view to:

- radically simplifying the statutory basis of the OLC. As one example, a new duty on the LSB to ensure that consumers have access to proper redress services, with detailed arrangements being specified contractually between the LSB and the redress provider, might replace the current inconsistent powers of intervention and direction;

- evaluating the transferability to the legal sector of the Ombudsman model in the energy and telecoms sectors, in which private and not for profit providers are recognised by regulators, with compliance being managed through a combination of regulatory requirements to ensure access to ADR and contractual requirements on firms to provide information and enforce Ombudsman decisions. It would in the LSB's view be important to ensure that only one ADR provider was in place to prevent the emergence of any incentives to "forum shop" by providers;
- ensuring that the OLC has the maximum ability to offer its services in other sectors to enable it both to offer benefits to consumers beyond the legal sector and to lower its unit costs.

138. In summary:

- the link between regulation and redress should be broken to ensure that more comprehensive redress is available to consumers and providers face fewer regulatory burdens;
- the statutory basis of the OLC should be radically simplified to enable it to more effectively respond in business time to changing circumstances in the legal sector and beyond.

9. Options for change

140. This section outlines:

- *Changes and legislative simplification that could be achieved either immediately or following the passing of the Consumer Rights Bill*
- *Suggested shorter term changes grouped under the headings of*
 - *Lower costs and entry barriers*
 - *Structural simplification*
 - *LSB facilitating change*
- *Legislative changes outside the Act*
- *Longer term issues: titles and professional privilege*

141. Although we consider that the maximum possible cost savings and simplification will not be achieved if reform is made piecemeal, the changes outlined in this section offer some potentially powerful quick wins (including the repeal of at least 115 pages and numerous clauses and sub clauses of legislation that are of themselves over regulation by Parliament). This would require legislative change but would neither require a complete overhaul of the current regulatory framework nor re-write of the Act. This section also outlines some significant legislative simplification we consider could occur outside the Act.

142. The shorter term changes suggested are divided into three categories: lower costs and entry barriers; structural simplification; and LSB facilitating change. In some areas of our work, processes could work faster and more smoothly with some minor changes. The LSB is limited in how effective it can be in meeting the spirit of the Act by some of the rules it contains. The third part of this section outlines some of the tools that could help our aim to simplify the existing regulatory arrangements.

Lower costs and entry barriers

143. Lower costs and entry barriers could be achieved by:

- removal of the ability of professional bodies to levy compulsory fees for non-regulatory activities – some £20-25m in total is currently levied in addition to the actual costs of regulation. Representative trade bodies would be free to charge membership fees to those who wished to join them, but there should be no compulsion⁶⁷;
- a new simple 'fit and proper' test for ABS owners, replacing the 20 pages of Schedule 13 to the Act. Current requirements are ineffective in practice and contribute to the extra costs of between £27,000 and £160,000 in addition to the costs of authorisation as an ABS⁶⁸. The unnecessary processes and system requirements in Schedule 11 (8 pages) should also be removed;

⁶⁷ This is already the case for some regulators such as IPREG

⁶⁸ This estimate includes salary costs, additional systems costs, external costs and application costs. The range of the estimate is influenced by differences in the size of firms being authorised as ABS, with costs

- permitting market entry to provide most legal activities unless a regulator has clear evidence of likely potential harm. Detailed authorisation rules are not needed in a world where consumer protection comes primarily from consumer law and there are strong general intervention powers over those firms subject to sector specific regulation. Additionally, there should be statutory backing for the maintenance of the professional principles and independence of all lawyers;
- aligning the reporting rules for infringements for ABS and non-ABS firms – the SRA’s recent lessening of firms’ reporting burden is welcome, but primary legislative change is needed to ensure a level playing field for ABS;
- amending professional rules so that they are not able to restrict in-house solicitors from acting direct for the public, if their employer has the necessary authorisation and meets regulatory requirements. This will enable increased competition and innovation in the market.

Structural simplification

144. Structural simplification could be achieved by:

- a general power for regulators to make the rules that are required by the Act – regulation often moves slower than market developments because of the need for affirmative resolution section 69 orders, which require official and Parliamentary time. This has delayed the applications for all new approved regulators and licensing authorities. The existing LSB rule approval process would prevent abuse of this power;
- a single approval process for new regulators and licensing authorities - entry as a regulator should remain subject to scrutiny and legislative requirements, but removing the need for separate approval for different categories of firm ownership would save significant time and cost for government, LSB, putative new regulators and new entrants firms alike;
- simplified consultation arrangements - removal of the requirement for the LSB to consult the OFT (soon to be the CMA)⁶⁹, the Legal Services Consumer Panel and the Lord Chief Justice separately, rather than as part of normal consultation, would save 2-3 months in the approval process for approved regulator and licensing authority applicants;
- cutting out the dual approval for new regulators by Lord Chancellor and LSB - the current duplication introduces delay, cost and uncertainty for regulators and those businesses that want to enter the market. A possible safeguard for this change could be to increase LSB accountability, perhaps through formal accountability to a Select Committee;

to larger firms being higher than for smaller firms. See Office of Fair Trading (2013) *Economic Research in Regulatory Restrictions in the Legal Profession- A Report for the Office of Fair Trading by Europe Economics* OFT 1460 (London) at para 1.14

⁶⁹ This new body will be formed from a merger of the Competition Commission and the Office of Fair Trading, and is due to assume its powers in April 2014. See <https://www.gov.uk/government/organisations/competition-and-markets-authority>

- faster Parliamentary process for becoming an approved regulator or licensing authority – making the process a negative as opposed to an affirmative one would avoid the inappropriate appearance of political influence on and control over legal services regulation. The Joint Committee on Statutory Instruments would continue to scrutinise SIs, and the ability to ‘pray against’ would remain
- economies of scale and greater consistency of decision through rationalisation of the current sanctions and appeals arrangements - use of the First Tier Tribunal as the single body for all appeals against regulatory decisions and a consistent approach to the civil standard of proof for all enforcement decisions would reduce cost, improve consistency, better protect the public and reduce the risks of regulatory arbitrage;
- remove outdated controls on solicitors’ remuneration - part III (sections 56- 75) of the Solicitors Act 1974 (13 pages of legislation), and its subsequent extension to SRA-regulated ABS, and the Lord Chancellor's Advisory Committee together set rules and principles for solicitors’ remuneration which are neither used by consumers nor offer benefits over and above the services of the Ombudsman in the vast majority of cases.

LSB facilitating change

145. To steer change in this direction in the short-term, improvements are needed in the LSB’s powers with the LSB having a legislative remit to review existing arrangements and, where necessary, impose reforms that are consistent with the principles of better regulation. Specific changes include:

- less prescription in the rule change approval process – replacing the high level of detail in the Act with a statement of policy on how the LSB will consider rule change applications in the light of the regulatory objectives, the principles of better regulation and the putative new duty to promote economic growth agenda would give greater certainty and flexibility alike;
- ability to “call in” existing rules and processes for assessment - this would prevent any detriment being caused by the continuing use of unsuitable rules set by the approved regulators. At present, legislation slows liberalising changes without tackling long-standing obstacles to change;
- duty to simplify regulatory arrangements - this would strengthen the power discussed above. So far, only the SRA has made any effort to undertake any form of “red tape challenge”. Placing the LSB and front-line regulators under a duty to simplify regulatory arrangements where possible would significantly strengthen the incentives on approved regulators to act themselves by raising the prospect of intervention if they failed to do so;
- less prescription in enforcement methods and repeal of Schedules 7, 8 and 9 (14 pages of legislation) – the LSB’s enforcement powers, whilst appearing draconian, are convoluted and time-consuming. Change would provide more

consistency with better regulation generally and the Macrory principles⁷⁰ in particular. General principles of public law, the requirements of better regulation and the section 49 requirement for the LSB to set out how it will use its enforcement powers would continue to apply to ensure transparency about the use of its powers.

146. The LSB also intends to consult shortly on the introduction of lay chairs for the boards of all approved regulators. Three out of the six regulatory boards currently have a lay chair. To give confidence to consumers over the independence of regulation from vested interests, and to help drive cultural independence, we are about to consider whether this should be made mandatory for all regulators' boards.

Legislative simplification

147. We consider that the Solicitors Act 1974 (around 60 pages of legislation) could be repealed in its entirety. Different parts of the following Acts, all of which contain clauses underpinning regulation by different approved regulators could also be repealed:

- Administration of Justice Act 1985 – which amends the Solicitors Act 1974 and regulates elements of solicitors' services;
- Courts and Legal Services Act 1990 – which made changes to the judiciary and in the way the legal profession was organised and regulated;
- Copyright, Designs and Patents Act 1988 – which made changes to the statutory basis of copyright law in the United Kingdom;
- Trade Marks Act 1994 – which provides both civil and criminal law sanctions for the misuse of registered trade marks;
- Access to Justice Act 1999 – which created the Legal Services Commission⁷¹ and made changes to how legal aid was spent.

148. In practice, some parts of these Acts would need to be incorporated within a revised and slimmed down Legal Services Act. The outcome should be simple, consistent, unified primary legislation across all parts of the sector.

⁷⁰ Macrory R *Regulatory Justice in a post-Hampton World* (2006). Professor Macrory identified 6 penalties principles that should be the basis for any sanctioning regime: 1. Sanctions should change the behaviour of the offender; 2. Sanctions should ensure that there is no financial benefit obtained by non-compliance; 3. Sanctions should be responsive and consider what is appropriate for the particular offender and the particular regulatory issue; 4. Sanctions should be proportionate to the nature of the offence and harm caused; 5. Sanctions should aim to restore the harm caused by regulatory non-compliance; and 6. Sanctions should aim to deter future non-compliance. For the penalties principles to be applied effectively it was recommended that regulatory frameworks should have the following characteristics: 1. Regulators should publish an enforcement policy; 2. Regulators should measure the outcomes of their enforcement activities and tailor their enforcement effort to improving these outcomes; 3. Regulators should always be able to justify the choice of enforcement actions and explain why these actions are appropriate; 4. Regulators should always follow up enforcement actions and ensure that their sanctions are credible to offenders; 5. Regulators should be transparent in what formal enforcement activity has been taken in order to safeguard all stakeholders; 6. Regulators should be transparent in the methodology for calculating administrative penalties.

⁷¹ Now the Legal Aid Agency

149. We further consider that the following statutory instruments (SIs) could be repealed in the event of structural change to the regulatory framework:

- all Legal Services Act section 69 orders, which provide authority to modify, or make other provision relating to the, functions of an approved regulator. Many existing functions are set out across a range of Acts, including those above. Repealing these section 69 orders would be dependent on the Act being amended to provide authority for regulators to make future changes. This would require rules about the issues currently contained in s69 orders;
- all Legal Services Act section 80 Orders – if regulators investigated potential code breaches as now and there was one appellate body, section 80 orders would not be required;
- all SIs made by the Solicitors Disciplinary Tribunal – in the event that appeals go to a single appellate body;
- Solicitors' (Non-Contentious Business) Remuneration (Amendment) Order 2012 (S.I. 2012/171) – unnecessary due to availability of ADR through LeO; and
- Solicitors' (Non-Contentious Business) Remuneration Order 2009 (S.I. 2009/1931) – again, unnecessary due to the existence of LeO.

150. A future review should consider in greater detail the full range of Acts, sections and SIs whose subject matter goes beyond just legal services regulation that could be consolidated or repealed.

Other longer term issues

151. Any future review of legal services regulation should also address two further issues:

- **Legal professional privilege**

152. The Supreme Court recently addressed this issue in a case asking whether legal advice given by an accountant could be subject to privilege⁷². The majority held that privilege should not be extended to communications in connection with advice given by professional people other than lawyers, even where that advice is legal advice which that professional person is qualified to give. It was suggested that for the court to do so would introduce unacceptable uncertainty, and any extension of privilege should be left to Parliament⁷³.

153. We consider that privilege should be viewed through the same lens as a modern approach to regulation: it should depend on the risks being posed and not simply

⁷² *R (on the application of Prudential plc and another) (Appellants) v Special Commissioner of Income Tax and another (Respondents)* [2013] UKSC 1

⁷³ *R (on the application of Prudential plc and another) (Appellants) v Special Commissioner of Income Tax and another (Respondents)* [2013] UKSC 1 at paras 51-52

attach to certain types of provider. We note Lord Sumption's dissenting opinion⁷⁴ and suggest that this issue should be included within the review proposed above.

- **Professional titles**

154. As explained at annex C, the Act preserved the historical link between professional titles and the ability to undertake certain legal activities. Professional titles play an important role in driving standards up and developing collective behaviours among providers. However, reliance on title alone does not fit with a risk based, outcomes focused approach to regulation.

155. Our preliminary view is that, in the longer term, providers might be authorised by a regulator to perform certain legal activities, and authorisation would be kept separate from title. Titles and related standard setting would remain with the professional bodies, but there should be no statutory obligation requiring a provider to hold a title to offer a legal service. Titles might therefore act both as a professional label and as a brand in the market place.

156. A regulator could designate the training and competence programmes of professional bodies as satisfying their requirements. The regulator in this case would be in charge of enforcement and sanctions on individual title holders in addition to its regulatory powers to sanction for breach of regulatory rules. The advantage here would be the separation of regulation from the professions while still retaining the brand and professional ethos associated with titles. Further work would be needed to prevent arrangements becoming duplicative and cumbersome in practice.

⁷⁴ At paragraph 114: '...privilege is a substantive right of the client, whose availability depends on the character of the advice which he is seeking and the circumstances in which it is given. It does not depend on the adviser's status, provided that the advice is given in a professional context.'

10. A long term vision for regulatory structure

158. This section outlines our conclusions that:

- *A single sharply focused regulator is likely to be best placed to deliver effective legal regulation in line with the principles of better regulation*
- *There are some significant challenges to achieving this in the near-term*
- *Important changes that can be made through more incremental reform should not be delayed*

Problems with the current model

159. All regulators in every sector face significant challenges in moving as quickly as the markets that they oversee. But these challenges are particularly acute in legal services as:

- boundaries between the different branches of the legal professions are becoming more fluid to enable integrated service offerings. The days of a clear distinction between consumer facing solicitor and the referral bar are already being overtaken by market change;
- the boundary between legal services and other professional services is becoming similarly fluid;
- ownership and funding models are becoming more diverse in the light of this fluidity in service. Moreover, the 2007 Act shifted the focus of regulation away from individuals and towards entities, which may contain professionals from all branches of the legal sector as well as non-legal professionals.

160. However the organisation of regulation is still tied not simply to the profession, but to individual sub-branches within it. And current regulators sit at some remove from the general disciplines of better regulation which bite on statutory bodies as a whole. Hence, while progress is being made towards leaner, more focused risk based, outcomes focused regulation, current structures impose significant drag on the ability of regulators to deliver, both individually and collectively.

161. The existing structure of regulation impacts particularly in the following ways:

- lack of consistency – currently the structure of multiple regulators tied to professions militates against consistent regulation across legal services eg there is no solicitor equivalent of the cab rank rule. The LSB can address this to some extent in relation to new arrangements. But, as noted earlier, the LSB has no power to ‘call in’ existing regulatory arrangements and force the pace of change;
- untargeted regulation – regulatory risks for those offering services to individual consumers and small businesses are likely to be significantly different to the risks arising where clients are large corporations; the current regulatory codes centred on consistent title-based regulation inevitably limits the tailoring of approach possible;

- disproportionate regulation – the current regulatory structure has different regulators often regulating the same activities, not only in different ways, but also imposing extra costs by doubling up (or more) the infrastructure required to regulate the activities as boundaries blur.

162. There is a danger therefore that:

- regulatory practice will become increasingly inconsistent between different regulators, with the incentive to “forum shop” for firms and confusion for consumers about what level of protection to expect likely to increase;
- some of the more innovative models, offering new types of services to both businesses and consumers alike, will find it increasingly difficult to find a natural “home” within this fragmented landscape. There is already significant evidence of this in the difficulty that the SRA has found in processing ABS applications from those offering “non-law firm” models;
- a structure that looks avoidably over-complex, anachronistic and expensive will increasingly lose credibility with public, industry and profession alike;
- handing regulation back to the profession would undermine the growth agenda as a whole by enabling the re-erection of barriers to entry to non-legal owners and service providers.

A new approach

163. We therefore believe that the case for more radical change to the regulatory structure than that made in the Act has grown in the intervening period and is likely to grow further in coming years.

164. The key point is to achieve far cleaner independence than in the current framework. The experience of the past five years is that, while this provision is slowly facilitating more independent, market opening and public interest based regulation, it also:

- leads to considerable frictional costs and arguments, which divert both regulators and professional bodies from their key purposes;
- fails to resolve the problems arising from a focus on regulators’ branch of the profession;
- necessitates a further layer of regulation in the form of oversight to prevent professional capture.

165. Annex D considers the advantages and disadvantages of six different options to deal with the issue. The analysis contained within this paper logically leads us to conclude that, if one were starting de novo, consistency within legal services regulation can be best achieved through the presence of a single legal services regulator unconnected to any of the existing frontline or oversight regulators. This type of structure would also be more transparent and much more easily understood by consumers and potential new entrants to the market. Further, costs would be

minimised under this model as a single body would both benefit from economies of scale and remove the need for a separate oversight body⁷⁵.

166. Independence from both sectional interests and from Government would be essential. If regulation is not independent it is liable to be unduly influenced by particular interests at the expense of the wider public and consumer interest. That does not mean a totally self-tasking body, totally divorced from those it oversees:

- an effective regulator clearly needs a wide range of skills, including from professional practice, both on its staff and around its Board table;
- the better regulation disciplines of transparency and effective consultation would be vitally important;
- effective arrangements for an institutional voice for consumers need to be put in place. And the case for a “Practitioner Panel” should also be revisited;
- there need to be tightly defined “touch points” for Government, but set out in a way which clearly preserve the decision-making autonomy of the regulator on both policy and operational matters. The legislation establishing the Competition and Markets Act may offer one model;
- there needs to be clear accountability, perhaps to Parliament as is being put in place for the PSA in health, rather than the Executive.

167. There is much to develop in this model. But we do not believe that it is wrongly conceived or impossible to develop in practice.

Challenges

168. However, we recognise that we are not starting from scratch. A move to a single body would pose a great variety of practical challenges:

- plans for major change to the regulatory framework risks creating regulatory uncertainty. Uncertainty is known to put off potential investors and get in the way of businesses planning long-term changes to their business models to increase their competitiveness and improve services to consumers (see annex E). Many providers are likely to have developed working practices and systems that they know deliver compliance with existing regulatory obligations at a relatively low cost. Uncertainty is likely to have destabilising effect. Therefore, it is important that Government provides a clear, realistic timetable for any major review and resulting changes. In the meantime the LSB should be given a clear mandate to pick up the pace of liberalisation, simplification and removal of unnecessary cost within the existing framework;
- the need to retain the strengths of the current regulators with their detailed knowledge of the areas of the sector they regulate. More broadly there remains a need to recognise the unique roles of smaller and more specialist parts of the profession – the importance of the Bar to the development of the law both in the UK and internationally, the historical basis of the Master of the

⁷⁵ See annex C for a more detailed discussion of the functions of the LSB in its oversight role.

Faculties and the highly specialised knowledge of both the trade mark and patent attorneys, for example – and to ensure that these are neither undermined as matter of policy or accident nor given unwarranted protection from market forces;

- the need to ensure that checks are built into the regulatory infrastructure to prevent any tendency of regulatory creep resulting in disproportionate regulation. Currently the LSB plays an important role in this regard;
- the level of change to primary legislation would be far greater than that necessary for the other changes canvassed in this paper. It is far from clear that it would attract or merit the necessary political priority in the short-term;
- there would be significant transitional cost and disruption, potentially over an extended period. The threats to existing regulatory activity in the intervening period could be significant and costly at a time of such significant change in the industry;
- the contribution of professional bodies would need to develop differently. They could continue to represent and promote both the interests of their members and the public but without having statutory regulator status and benefitting from the guaranteed income they currently enjoy. Businesses and individuals should be able to decide whether they wish to join a representative body, and those bodies should have to work to attract members based on their merits. But there is a role for them to develop in relation to standard setting and accreditation and there may be lessons to be learnt from the relationship between professional bodies and regulators from other sectors, for example the medical Royal Colleges.

169. We refer back to the point raised above at paragraph 94, that we suspect the overall level of regulation introduced by regulators, if subjected to cost benefit analysis, would prove too high. Regulation operated in practice rarely works as effectively as might be imagined when it was developed by policy-makers.

Next steps

170. Despite these challenges, we believe that the case for considering a single legal services regulator is strong. It is our view that an independent review is desirable to:

- develop and test the hypothesis further in the light of the scale of implementation challenge it would present;
- consider whether any of the other options presented in annex D may be better solutions in the longer term or as staging posts towards a single body;
- develop a practicable, costed implementation plan to move whatever outcome is determined.

171. However we do not believe that this significant review should delay the incremental changes set out in section 10. While we see structural reform as both desirable and inevitable in the long-term, more immediate progress can, and

should, be made more quickly, both within the existing regulatory structure and by incremental, rather than fundamental changes to it.

172. What we emphasise above all, however, is the need to focus on driving economic growth, encouraging innovation and protecting both consumers and the wider public interest, by continuing to simplify the regulatory rule book and modernise regulatory practice by targeting risk. A vibrant legal market with high ethical standards, underpinning a healthy economy, depends on this kind of regulatory practice. Government's focus must be on how to achieve this, not on institutional reform as an end in itself.

11. Conclusion

174. 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.

Glossary of Terms

the Act	Legal Services Act 2007
ABS	Alternative business structures. Since October 2011 non-legal firms have been able to offer legal services to their customers in a way that is integrated with their existing services. Or law firms have been able to develop their portfolios to compete across wider areas compared with their existing experience.
Approved regulator	A body which is designated as an approved regulator by Parts 1 or 2 of schedule 4, and whose regulatory arrangements are approved for the purposes of the LSA and which may authorise persons to carry on any activity which is a reserved legal activity in respect of which it is a relevant approved regulator.
Authorised Person	A person authorised to carry out a reserved legal activity
BSB	Bar Standards Board – the independent regulatory arm of the Bar Council.
CLC	Council for Licensed Conveyancers – the regulator of Licensed Conveyancers.
Consumer Panel	The panel of persons established and maintained by the Board in accordance with Section 8 of the LSA (2007) to provide independent advice to the Legal Services Board about the interests of users of legal services.
Licensing Authority	An approved regulator which is designated as a licensing authority to license firms as ABS
LSB or the Board	Legal Services Board – the independent body responsible for overseeing the regulation of lawyers in England and Wales
LeO	Legal Ombudsman - The single organisation for all consumer legal complaints
OFT	Office of Fair Trading. A <u>non-ministerial government department</u> of the <u>United Kingdom</u> , which enforces both <u>consumer protection</u> and <u>competition law</u> .
OLC	Office for Legal Complaints. Body established by the Legal Services Act to establish an independent Legal Ombudsman service (see LeO)
Principles of better regulation	The five principles of better regulation; being proportional, accountable, consistent, transparent and targeted
Regulatory objectives	There are eight regulatory objectives for the LSB that are set out in the Legal Services Act (2007): protecting and promoting the public interest supporting the constitutional principle of the rule of law improving access to justice protecting and promoting the interests of consumers promoting competition in the provision of services in the legal sector encouraging an independent, strong, diverse and effective legal profession increasing public understanding of citizens legal rights and duties promoting and maintaining adherence to the professional principles of independence and integrity; proper standards of work; observing the best interests of the client and the duty to the court; and maintaining client confidentiality.
Regulatory rules	Set out the regulatory arrangements that approved regulators must comply with in order to be designated as approved regulators for specific reserved activity.
Reserved legal activity	Legal services within the scope of regulation by the approved regulators

SDT	Solicitors Disciplinary Tribunal. Adjudicates upon alleged breaches of rules or the Code of professional conduct by Solicitors
SRA	Solicitors Regulation Authority - regulatory body of the Law Society

Annexes

Annex A: Summary of Regulatory Policy Institute *Understanding the Economic Rationale for Legal Services Regulation* Report for the Legal Services Board prepared by Dr Christopher Decker and Professor George Yarrow (October 2010)⁷⁶

Why regulate legal services?

1. The main rationale for regulating legal services relates to issues about quality of the service being provided and imbalances in knowledge and power, known as information asymmetries, between suppliers and consumers. Another justification for independent regulation of legal services is to prevent any anti-competitive professional restrictions or practices. Historically these have included fixed or minimum prices, and restrictions on organisational form or advertising. These types of practices lead to higher prices and less choice for consumers.
2. Regulation may also be introduced to prevent professionals using their technical knowledge to exploit uninformed consumers. This problem is not unique to legal services and is a possibility with any other occupations, for example car mechanics, where the provider is responsible for both diagnosing and remedying the consumer's problem. Regulation of legal services uses tools such as codes of conduct and professional ethics to address the risk of providers exploiting their position.
3. Regulation of legal services can also be founded on the idea of economic equity. A key concern is that some consumers are restricted from accessing important legal services because of their price. Affordability problems may be aggravated by 'gold plating' service quality, which over-compensates for perceived risks to consumers and unnecessarily inflates costs. Implementing procedures for consumer complaints and redress are also examples of regulatory tools based on the idea of equity. Other initiatives can focus on efficiency issues such as how services are delivered.

Tailoring regulation

4. Some legal services regulation is tailored to address specific problems and risks in the market. It is important to balance prescriptive and specific rules aimed at a particular risk with ensuring that regulation is proportionate, and that other areas of activity not requiring prescriptive rules are not burdened by over-regulation. Achieving a balance between prescriptive regulation for high risk and high impact activities, and allowing lower risk activities⁷⁷ to continue without unnecessary burdens, will require a flexible framework that targets regulation where needed but

⁷⁶ Available at <https://research.legalservicesboard.org.uk/wp-content/media/Why-regulate-legal-services-RPI-report.pdf>

⁷⁷ On the challenges low risks present for regulators and a strategic framework for their management see Baldwin R, Black J and O'Leary G, *Regulating Low Risks: Innovative Strategies and Implementation*, LSE Legal Studies Working Paper No. 9/2013, June 2013

can also apply a lower level set of principles across a wide range of legal activities⁷⁸. There are examples of this regulatory approach in other professional service markets, such as the requirement under the European Commission Merger Regulation⁷⁹ to balance any potential anti-competitive effects of a merger against potential efficiencies. This framework can be applied at different levels of specificity. Another wide ranging example is the use of impact assessments, in that all potential impacts are measured and balanced prior to the introduction of new regulation.

Issues with self-regulation

5. Legal services involve both technical skills and the specialist application of knowledge, meaning that many consumers will be unable to judge quality before purchasing. Self-regulation arose as a way of signalling to consumers that a certain group of providers adhered to a common standard. This quality 'badge' reduced the risk to consumers of unwittingly purchasing low quality services.
6. One problem raised by self-regulation is judging how to set the right level of quality among members, and how adherence to this standard should be monitored. To tackle this, quality monitoring that can be disproportionate or 'gold plated', and impose excessive compliance costs on providers, may be used. Training and entry requirements can also be set, but they do not provide incentives to maintain ongoing quality levels. Further, self-regulation is vulnerable to price-setting by providers, which impacts on affordability and access to services for consumers⁸⁰.
7. In a self-regulatory framework professional bodies often introduce constraints on who can provide services in order to maintain quality and uphold their particular brand. However, these measures can disproportionately stifle competition. It is also possible for the profession to be captured by sectional interests, such as large law firms. Often self-regulation tends to be set at the level of highest risk, resulting in restricted competition and unnecessarily high prices for consumers.

Considerations for practically applying the rationale

- It is important to tailor regulatory interventions, having regard to both the nature of the matter (civil, criminal, etc) and also to the type of consumer.
- The most compelling reason for regulating legal services relates to quality and information asymmetries between suppliers and consumers. Important questions to ask in this context include: what level of information is available to the consumer? How knowledgeable is the consumer? What are the potential

⁷⁸ For a general discussion of the advantages of principles based regulation see Black J *Forms and paradoxes of principles-based regulation* Capital Markets Law Journal, Vol 3(4) at p 430-434
<http://www.lse.ac.uk/collections/law/staff%20publications%20full%20text/black/forms%20and%20paradoxes%20of%20pbr%202008.pdf>

⁷⁹ Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation)

⁸⁰ See Hepburn G, *Alternatives to traditional regulation*, OECD Report, p.41.
<http://www.oecd.org/gov/regulatory-policy/42245468.pdf>

forms of harm to consumers that might flow from them being unable to properly assess quality?

- The relationship between entry qualifications and quality is central to legal services regulation. While there may be reasons for practitioners to have high levels of specialist skills to preserve and maintain quality, this does not universally apply to all areas. When considering regulation it is important to first assess whether the regulation is necessary or appropriate given the level of risk to consumer harm in the activity.
- The level of knowledge of consumers also has a bearing on the appropriateness of regulatory intervention. Questions to ask include: how often does the consumer use legal services?
- The structure of supply of legal services can have important implications for quality and for the intensity of competition. Questions to ask include: what rules appear proportionate and reasonable given their stated objective and purpose? Do rules differ between different sectors and activities, if so how?

Annex B: Summary of existing consumer legislation

Current consumer protection landscape

1. Consumer protection in the legal services market is made up of overlapping protections, which generally fall into two categories:
 - Sector-specific protections available to consumers of regulated legal services; and
 - General protections in place for all consumers, regardless of whether the service purchased is subject to sector specific regulation or not.

UK consumer protection legislation

2. These include wide-ranging competition and consumer laws, as well as those dealing with fraud. Some of the main protections that can apply to legal services include:
 - Cancellation of Contracts made in a Consumer's Home or Place of Work etc. Regulations 2008
 - Competition Act 1998
 - Consumer Credit Act 1974 [and 2006]
 - Consumer Protection Act 1987
 - Consumer Protection (Distance Selling) Regulations 2000
 - Consumer Protection from Unfair Trading Regulations 2008
 - Enterprise Act 2002
 - Fraud Act 2006
 - Regulatory Enforcement and Sanctions Act 2008, Part 3.
 - Supply of Goods and Services Act 1982
 - Unfair Contract Terms Act 1977
 - Unfair Terms in Consumer Contracts Regulations 1999

European directives

3. The following directives aim to ensure Europe-wide minimum standards in the sale and quality of goods and services:
 - Directive 93/13/EEC on unfair terms in consumer contracts
 - Directive 2011/83/EU on consumer rights
 - Directive 99/44/EC on certain aspects of the sale of consumer goods and associated guarantees

General protections: quality, selling practices and loss of money

4. There are currently a number of consumer protections in place covering quality, services and sales. Consumers of legal services have recourse to these protections. However, the particular type of protection in place and how it is

exercised and enforced depends very much on the nature of the problem faced by a consumer.⁸¹

5. A number of protections concerning service and sales are enforced by public bodies with no private right of action. For detriments caused relating to service and sales practices public bodies such as Trading Standards and the Office of Fair Trading (OFT)⁸² have powers in place allowing them to investigate and impose financial penalties on providers and ban them from operating⁸³. Despite these protections in place, there remain gaps in accessible remedies for consumers.. There are limitations on the ability of public bodies to deal effectively with the volume and complexity of complaints made to them. For example, Trading Standards has limited capacity to focus on complaints in the legal services sector and local priorities can mean that enforcement is inconsistent.
6. Some consumer bodies are designated to make super-complaints to the OFT on behalf of consumers. Super-complaints can be made if a designated body identifies a feature of the market that appears to be harming the interests of consumers. Since 2002 the laws around enforcement have been strengthened and the OFT now has the power to obtain court orders against businesses who breach certain laws⁸⁴. From April 2014 the OFT will be replaced by the CMA and its enforcement functions, including those for super complaints, will be transferred across to the new body⁸⁵.
7. For those consumers who suffer detriment arising from criminal activity such as stolen monies and other forms of financial crime, enforcement and prosecution is carried out by the police and courts⁸⁶. In some cases redress may be possible when criminal breaches occur, such as retrieving stolen money⁸⁷, but only if the offender has realisable assets.
8. Consumers may undertake private legal action against a provider for poor quality of service provided. Consumers may seek redress for issues concerning quality but they are required to show that their provider failed to exercise the same degree of care that a “reasonable” provider would have exercised. However, private action is often seen as costly, risky, complex and slow. Consumers are often unwilling to

⁸¹ On a discussion of the private right of action and public enforcement responsibilities see: Law Commission, <http://www.officialdocuments.gov.uk/document/cm83/8323/8323.pdf>

⁸² The OFT will soon be incorporated into the new Competition and Markets Authority

⁸³ For example, Consumer Protection from Unfair Trading Regulations (2008); Cancellation of Contracts made in a Consumer’s Home or Place of Work etc Regulations (2008); also Part 8 of the Enterprise Act (2002).

⁸⁴ Enterprise Act (2002)

⁸⁵ On the role and function of CMA see the Enterprise and Regulatory Reform Act 2013.

⁸⁶ Enforcement can be done under the Fraud Act (2006). On examples of financial crime occurring during the estate administration process see the case studies in The Law Society’s submission to the LSB’s call for evidence for will-writing, 16 January 2013. The submission may be found at:

[http://www.legalservicesboard.org.uk/Projects/pdf/letter from law society ea kenny c160113 2.pdf](http://www.legalservicesboard.org.uk/Projects/pdf/letter%20from%20law%20society%20ea%20kenny%20c160113%202.pdf)

⁸⁷ Proceeds of Crime Act 2002.

challenge a lawyer in court. These factors act as a deterrent for many consumers in seeking private redress⁸⁸.

Future consumer rights landscape

9. The consumer landscape is likely to change in the future with the draft Consumer Rights Bill⁸⁹ (see box below), along with other changes including the implementation of the European Alternative Dispute Resolution (ADR) Directive and moves to widen the scope of consumers undertaking private action for redress.
10. The Consumer Rights Bill both streamlines overlapping legislation into one Bill and creates new rights for consumers. While not yet law and subject to change, the Bill's core rights are:
 - Right to clear and honest information before you buy;
 - Right to get what you pay for;
 - Right that goods and digital content are fit for purpose and services are provided with reasonable care and skill; and
 - Right for faults to be fixed free of charge, or a refund or replacement provided.
11. Clarification around enforcement and consumer rights is expected to benefit consumers by enabling them to spend less time understanding their rights and less resource applying them. The Bill will enhance regulatory enforcement by allowing Trading Standards to work across local authority boundaries and improve cooperation between different offices. Requiring providers to be more transparent around pricing and their terms of business in contracts should mean that consumers will have greater confidence when entering into contracts. Under the new proposal, consumers may also be able to seek redress through Trading Standards in some circumstances.
12. As the consumer protection landscape is being simplified through the introduction of the Consumer Rights Bill, EU law will also mean that consumers should have the chance to resolve their disputes without going to court (see box below). The weakness of this directive, however, is that it will not be mandatory for traders to participate, unless individual Member States mandate otherwise (this is unlikely in the UK).

Conclusion

13. There is a wide range of consumer protections already in place which are enforced by public bodies. Sector-specific legal services regulation pre-cede many of these general protections. In terms of existing protections concerning quality, service and sales, it is possible that under the Consumer Rights Bill these areas could be enforced across legal services as a standard baseline of protection. In light of this,

⁸⁸ See for example University of Lincoln, Lincoln Law School, 2008: Representative Actions and Restorative Justice, www.bis.gov.uk/files/file51559.pdf

⁸⁹ For more information about the Bill see <https://www.gov.uk/government/publications/draft-consumer-rights-bill>

in the future it will be necessary to review sector-specific protections and to identify if any obligations can be safely removed.

14. With the consolidation and clarification of consumer rights it is also feasible that legal regulators could be appointed to enforce general protections in legal services, just as economic regulators have in their specific sectors. Allowing legal regulators who have sector specific experience to enforce provisions in the Consumer Rights Bill would help reduce resourcing pressure on Trading Standards. Moreover, transferring the cost of enforcement away from a publicly funded body to legal service regulators (who are paid for by the industry) would be in line with Government plans to reduce burdens on the taxpayer.

Consumer Rights Bill

The significance of this Bill is that it introduces a statutory right for services to be provided with reasonable care and skill. The Bill also simplifies legislation and makes it easier for consumers to enforce their rights.

How is it enforced?

Mainly by Trading Standards who are empowered to work across local authority boundaries. Also economic regulators are able to enforce in their own sectors. ADR is promoted to ensure that courts are the option of last resort. The Competition and Markets Authority will have enhanced powers in enforcement.

Implications for legal services

The Bill may impact on consumers in legal services by strengthening rights in the areas of: (1) service; (2) unfair contract terms; (3) enforcement; (4) other measures.

Services

Measures include introducing a statutory right that services must be provided with reasonable care and skill and that the service must comply with the information given by the trader in certain circumstances.

Unfair contract terms

Contract terms (including prices) must be transparent and prominent.

Enforcement

Measures in this area include simplifying consumer law enforcers and to enable Trading Standards to work across local authority boundaries.

Other measures

Strengthen redress for consumers who have suffered from breaches of consumer law. Providers to be responsive to consumer protection issues by supporting compliance through compliance officers, complaints handling and improved record keeping.

European Alternative Dispute Resolution directive

The ADR proposes that all EU consumers should have the chance to resolve their disputes without going to court, regardless of product or service type. The directive only applies to consumers who are in dispute with traders.

ADR encourages member states to build upon existing ADR schemes. It sets minimum quality standards and that it is accessible and transparent, and that disputes are resolved in a timely manner within 90 days.

How is it enforced?

By Member States. The weakness is that it is not mandatory for traders to participate, unless individual member states mandate otherwise (unlikely for the UK).

Implications for legal services

There may be positive effects on unregulated providers as they seek alternative, more cost effective, forms of dispute resolution.

ADR is likely to have particular implications for the Legal Ombudsman, especially the expectation that the Ombudsman disputes are resolved in 90 days. The Ombudsman may have to revisit the 6 month time limit for complaining after the last correspondence received from lawyers. There may also be scope to introduce a procedure for collective claims in the legal sector.

There will be implications for legal service providers, including better signposting to ADR on providers' websites.

Summary of key consumer protections

Cancellation of Contracts made in a Consumer's Home or Place of Work etc. Regulations 2008

These regulations cover contracts that are made during both solicited and unsolicited visits by traders and apply to all contracts with a total payment of more than £35. The regulations set the cooling off period to be seven calendar days and require cancellation rights to be clearly displayed in any written contract or provided in writing if there is no written contract.

Competition Act 1998

The Competition Act prohibits agreements which are intended to, or have the effect of, "preventing, restricting or distorting competition in the UK". The Act also prohibits the abuse of a dominant position in the UK or part of the UK.

Consumer Credit Act 1974 (and 2006)

The Act dictates how credit providers must treat consumers. It includes provisions regarding debt recovery, cooling-off periods and liability for breaches of contract or misrepresentations of the good or service that was purchased on credit.

Consumer Protection Act 1987

The aim of the Consumer Protection Act is to help safeguard the consumer from products that do not reach a reasonable level of safety. The Act makes producers liable for personal injury, death or damage to a consumer's property caused by defective products.

Consumer Protection from Unfair Trading Regulations 2008

The Regulations prohibit unfair, misleading and aggressive commercial practices. The Regulations include a general prohibition of unfair practices where these could affect the average consumer's behaviour and also ban specific practices that are unfair in all circumstances.

Consumer Protection (Distance Selling) Regulations 2000

The Regulations aim to provide a minimum level of protection for consumers who purchase goods or services by means of distance communication (e.g. internet, mail order, email, fax and telephone). They include the right to a cooling-off period and to cancel the contract. If goods are faulty and do not do what they are supposed to, or do not match the description given, consumers have the same rights under the Sale of Goods Act 1979 as when buying face to face.

Enterprise Act 2002

The Act gives the Office of Fair Trading the power to apply to the court to disqualify an individual from being a director of a company. In addition, designated consumer bodies (e.g. Which?) will be entitled to apply for rights to bring damages claims on behalf of consumers.

Fraud Act 2006

The Act created a new general offence of fraud, which can be committed in three ways: fraud by false representation; fraud by failing to disclose information; and fraud by abuse of position.

Regulatory Enforcement and Sanctions Act 2008, Part 3

The Act provides Government with the powers to make an order by statutory instrument empowering enforcement agencies to impose sanctions such as the return of payment to consumers.

Supply of Goods and Services Act 1982

The Act requires businesses to supply services with reasonable care and skill and, unless agreed to the contrary, within a reasonable time and to make no more than a reasonable charge.

Unfair Contract Terms Act 1977

The Act regulates contracts by restricting the operation and legality of some contract terms. It limits the applicability of disclaimers of liability, rendering terms excluding or limiting liability ineffective or subject to reasonableness, depending on the nature of the obligation purported to be excluded and whether the party purporting to exclude or limit liability is acting against a consumer.

Unfair Terms in Consumer Contracts Regulations 1999

The Regulations protect consumers against unfair standard terms (this excludes core terms, including the price) in contracts they make with traders. The Regulations require that a standard term must be expressed in plain language.

Annex C: Historical context of legal services regulation

1. Under the Act regulation works in two main ways:
 - section 12 and schedule 2 to the Act detail six reserved legal activities, which may only be provided by authorised persons (including entities). This acts as a form of exclusivity granted by the State to those deemed to be appropriately qualified;
 - holders of particular professional titles, such as barrister, solicitor and licensed conveyancer, are regulated in all of the work they undertake irrespective of whether it is reserved or not. In this way regulation attaches to the title of the provider rather than the activity.
2. In addition, Parliament has determined that some services that would fall within the Act's definition of legal activity being regulated by statute, but not as reserved legal activities. Examples include immigration advice and claims management services. The outcome of these overlapping regimes is that non-reserved legal activities carried out by unregulated persons can be undertaken outside of all sector specific regulatory oversight. For most legal activities, in most areas of law, there are no restrictions on who can deliver services to consumers. Anybody can set up shop in these areas without any competence or suitability checks, without any oversight and without providing access to redress mechanisms. From a providers' perspective, holders of professional titles wishing to offer these services are regulated to the same standard as for the reserved activities, placing burdens on them not faced by unregulated competitors.
3. Importantly, whether a consumer goes to a regulated or an unregulated provider impacts on their ability to obtain redress. The OLC was created as a key component of the Act to facilitate an easily understood and accessible system of redress for all individuals and small business consumers with a service grievance. However, the jurisdiction of the Ombudsman is limited to services provided by authorised persons, meaning persons authorised by an approved regulator to undertake a reserved activity. Therefore, whether a consumer has access to ADR through the Ombudsman or not depends on the provider they choose.

The reserved legal activities

4. The reserved activities are fundamental to the structure of the Act. For example, they are central to the definition of an authorised person (section 18), to the grant of licences to ABS (section 111) and to the designation of a regulator as an approved regulator (section 20). The origins of the reserved legal activities can be traced back, in some cases, many centuries. Overall their history is obscure and often the result of simply confirming then current practice or of political influence. A good example of this is Pitt the Younger's granting in 1804 of the conveyancing reservation in order to appease the legal profession over plans to increase taxes on articles and practising fees. Further, in the few Hansard debates that do exist

regarding the reserved activities, protectionist influences are often evident⁹⁰. The reserved activities cannot be considered a suitable foundation for a modern approach to regulation.

5. Reservation as currently understood is a very blunt instrument. It does add some consumer protection above that available through general law. However, it does so through establishing monopolies, the existence of which might well have negative effects on access to justice, competition and some of the other regulatory objectives.

Regulation by title

6. The different branches of the legal profession have developed on an ad hoc basis over hundreds of years, as lawyers that delivered similar services joined together to form self-regulating organisations and collectively set the conditions for membership. This involved controlling entry, with the starting point often being a general legal qualification. The standards of behaviour to be maintained and rules and regulations saying what members can and cannot do have been established and set out in various codes of practice. Systems also apply to provide for members not meeting the prescribed standards or breaching the rules to be disciplined and potentially expelled. The totality of these arrangements make up the regulatory arrangements as defined under the Act.
7. Titles such as solicitor and barrister are given to members of different arms of the profession to enable consumers to distinguish between them. Regulation is then attached to the title, meaning that requirements apply no matter what combinations of legal work the provider undertakes and irrespective of any difference in expertise and skill required for different activities.
8. Over time the number of branches of the legal profession has increased and through legislation Parliament has incrementally granted exclusive rights of practice over certain legal activities – the reserved activities– to different providers, making the professional bodies the statutory regulators of providers carrying out those activities. In introducing the Act the existing regulatory landscape was simply carried across as was. The result is a landscape that the Clementi review⁹¹ described as being ‘punctuated with gaps, overlaps and anomalies’.
9. Under the current framework what is regulated, the level of consumer protection and burdens on business are largely determined by who provides the service and not the risks involved. The better regulation principles require that regulatory intervention must both target identified risks and be proportionate to those risks. There is an urgent need for policymakers to initiate a clean sheet review and consider on a risk basis what activities within legal services require sector specific regulation and what form that regulation should take. In line with the principles of

⁹⁰ See further Legal Services Institute *Reserved Legal Activities- History and Rationale* (August 2010)

⁹¹ Clementi, Sir David *Review of the Regulatory Framework for Legal Services in England and Wales Final Report* (December 2004)

better regulation, there should be intervention only when required to address risks that are not adequately mitigated by non-regulatory options.

Annex D: Alternative options for future regulatory structures

1. This annex introduces six options for structural change in the legal services market. The options for structural change will be assessed against the following four tests for a regulatory structure:
 - independence - an ability to assess regulatory requirements irrespective of vested interests;
 - simplicity - can the regulatory system be explained simply? This is not the same as expecting all consumers to understand how legal services are regulated;
 - minimised and better targeted costs - regulation imposes costs on those it seeks to protect; it is therefore essential that the system imposed allows those costs to be minimised. Regulation must be both proportionate and targeted;
 - transparency and accountability - regulation should be independent of government and the profession, and avoid regulatory creep.
2. For each option we would stress the need for legislative simplification. Also, in line with guidance from the Department for Business, Innovation and Skills, we would suggest that the regulators under each option should review their rulebooks regularly against the better regulation principles and also against the regulatory objectives.

Option 1: Single independent legal services regulator

3. We consider that the optimal way forward is the introduction of a single independent legal services regulator. We explore this option in more depth above in section 10.

Option 2: Self-regulation with oversight

4. This option would see a return to self-regulation of the profession, with the professional bodies fulfilling both representative and regulatory functions. Oversight could be provided by a LSB type body.

	Independence	Simplicity	Minimised and targeted costs	Transparency and accountability
Advantages				Professional bodies held accountable by LSB type body
Disadvantages	Total lack of independent regulation	Multiple regulators retains need for independent oversight	Inefficient structure imposes long term costs	Lack of independence raises issues of transparency, credibility and accountability

	LSB type body hampered by structure in its efforts to drive independent regulation	Structure difficult for consumers or existing or potential market participants to understand	Need for oversight creates extra regulatory burden on providers	
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Option 3: Retain current framework following legislative simplification

5. This option would retain the existing regulatory architecture but with a simplified legislative framework. While we conclude that regulatory simplification could provide scope for consolidation among the existing regulators, those remaining after consolidation could in principle continue to operate as separate regulators.

	Independence	Simplicity	Minimised and targeted costs	Transparency and accountability
Advantages			Minimises short term costs of moving to an alternative framework	Regulators held accountable by LSB
Disadvantages	Lack of legal or operational independence	Multiple regulators retains need for independent oversight	Inefficient structure imposes long term costs	LSB hampered by Act in its efforts to help regulators improve their performance
		Structure difficult for consumers or existing/ potential market participants to understand	Need for oversight creates extra regulatory burden on providers	Lack of independence raises issues of transparency, credibility and accountability

Option 4: Multiple independent legal services regulators with oversight

6. The regulatory architecture in this option would be similar to that in option one, with some possible consolidation of the regulators following legislative simplification. To satisfy the test of independence under this model, it is imperative that the regulatory bodies become both legally and operationally independent entities. It must be the regulatory body, not the professional body, which is the authorised regulator for any given branch of the profession.

	Independence	Simplicity	Minimised and targeted costs	Transparency and accountability
Advantages	Regulators can break from traditional practices and focus more effectively on risk, and encourage greater innovation and competition among providers		Minimises costs of moving to an alternative framework	Independence of regulators aids transparency and accountability

				Regulators held accountable by oversight body
Disadvantages		Multiple regulators retains need for independent oversight	Need for oversight creates extra regulatory burden on providers	
		Structure difficult for consumers or existing/ potential market participants to understand	Inefficient structure of multiple regulators plus oversight imposes long term costs	

Option 5: Activity based legal services regulators with oversight

7. This model would entail legislative reform to establish two or more independent regulators focusing on different activities, for example advocacy, litigation, or other specialist areas of legal practice. Activities would be subject to this higher level regulation where the risks are shown to be sufficient to warrant it, with minimum protections (such as access to an independent form of ADR) available to consumers of other legal services.

8. The new financial services regime is a useful example here. In that sector some firms are regulated by both the Prudential Regulation Authority (responsible for prudential regulation of systemically important firms, including banks, insurers and certain investment firms) and the Financial Conduct Authority (responsible for the conduct of business regulation of all firms). In addition, the Financial Policy Committee considers prudential regulation issues across the whole of the UK's financial system but does not have direct regulatory responsibility for any particular types of firm. This new framework is demonstrating how separate regulators with independent mandates, but who are involved in regulating the same firms, can operate on issues where cooperation and coordination is required using memoranda of understanding.

	Independence	Simplicity	Minimised and targeted costs	Transparency and accountability
Advantages	Regulators are fully independent		Responsibility for only one activity would allow regulators to target risk more accurately	Independence of regulators aids transparency and accountability
				Regulators held accountable by oversight body
Disadvantages		Oversight required to ensure consistency of minimum standards across activities	Need for oversight creates extra regulatory burden on providers	

		Structure difficult to understand for consumers or existing/potential market participants	Short term costs incurred in move to new structure	
		Providers may be regulated by more than one regulator	Inefficient structure of multiple regulators plus oversight imposes long term costs	

Option 6: Introduction of a professional services regulator

9. A final option for structural change is the introduction of a regulator responsible for all professional services. This single cross-profession regulator would need to be capable of understanding risks inherent in a range of business models. As globalisation takes hold and professional services firms increasingly integrate across practise lines regulation may need to develop further to more effectively handle the range of businesses and risks that arise.

10. On balance, while such a model has significant advantages, we do not believe that it is the LSB's role to recommend solutions to wider regulatory problems. This is instead the role for Government should it wish to take a more radical approach to the regulation of professional services.

	Independence	Simplicity	Minimised and targeted costs	Transparency and accountability
Advantages	Regulator is fully independent	Simple regulatory structure easily understood by consumers and potential new market entrants	In the long term regulatory burden is lower for providers. No extra oversight body needed	Single body structure much more transparent for consumers
		No separate oversight body needed	Economies of scale will reduce cost of regulation, making UK providers more competitive	Body held accountable by MoJ or parliamentary/ Privy Council scrutiny
Disadvantages			Short term costs incurred in move to new structure	
			Possibility of insufficient expertise to cover full range of activities/services	

Options for oversight

11. We consider that oversight for the above frameworks could come from three possible sources:

- an LSB type body;
- a professional services oversight regulator; or

- Parliament/ Privy Council/ MoJ (with or without the CMA for competition purposes).

12. These bodies would have to undertake varying combinations of the functions currently performed by the LSB, which we have identified in section 5. We consider that for each model identified above oversight would be required as indicated in the table below.

Option for change	Self-regulation	Retain current framework following legislative simplification	Multiple independent legal services regulators	Independent activity based legal services regulators	Single professional services regulator
Possible source of oversight	LSB type body or professional services regulator	LSB type body or professional services regulator	LSB type body or professional services regulator	LSB type body or professional services regulator	Parliament/ Privy Council/ MoJ
Functions of oversight	Ensuring independence of regulation	Ensuring independence of regulation	Monitoring regulator performance	Monitoring regulator performance	Monitoring regulator performance
	Monitoring regulator performance	Monitoring regulator performance	Consideration of designation applications	Consideration of designation applications	Approval of practising fee levels
	Rule approval	Rule approval	Approval of practising fee levels	Approval of practising fee levels	Complaints/ redress
	Consideration of designation applications	Consideration of designation applications	Consistency of minimum standards	Complaints/ redress	Policy development
	Approval of practising fee levels	Approval of practising fee levels	Complaints/ redress	Policy development	
	Consistency of minimum standards	Consistency of minimum standards	Assistance with standards of regulation, education and training	Assistance with standards of regulation, education and training	
	Complaints/ redress	Complaints/ redress	Regulatory conflict		
	Assistance with standards of regulation, education and training ⁹²	Assistance with standards of regulation, education and training	Policy development		

⁹² This duty is currently imposed on the LSB by section 4 of the Act

	Resolving regulatory conflict	Resolving regulatory conflict			
	Policy development	Policy development			

Annex E: Changes in competition in different solicitor market segments

Ten observations about competition in solicitor market segments 2010/11-2012/13

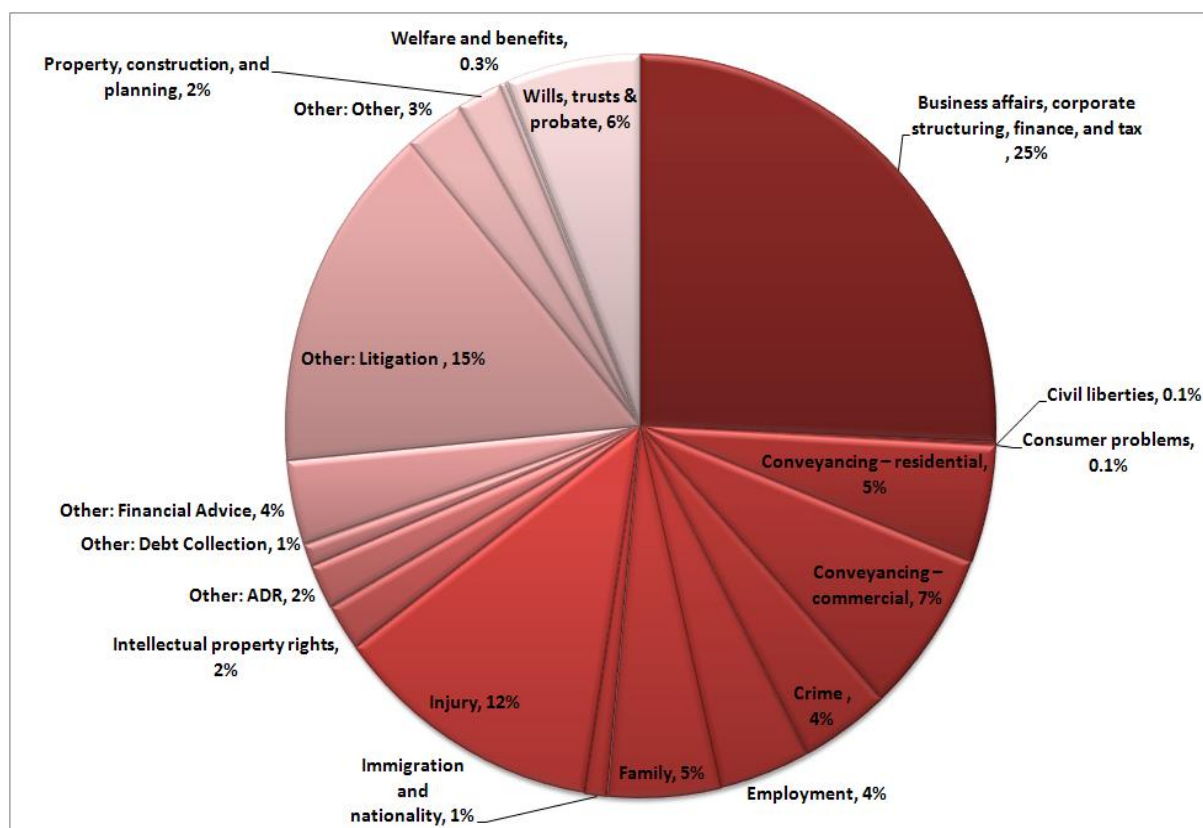
Most market segments are national or have the potential to be

1. A range of evidence points to there being no barriers to services being delivered nationwide. This is most obvious in conveyancing, where providers based in all areas of the country offer services to consumers using the internet. Looking at research into consumer behaviour suggests that search areas are presently limited by the challenge of comparing providers. We believe the potential for brands in both the regulated and unregulated sector to change this situation is significant. Bigger markets offer greater economies of scale and ultimately lower cost services.

Real market values have remained largely constant in the past three years

2. Real turnover for these firms has fluctuated between +/- 1% of 2010/11 levels, despite a greater proportionate fall in the number of law practices overall. In 2010/11, there were 9,120 firms reporting turnover, with a total turnover of £18.9bn. In 2012/13, there were 8,745 firms reporting turnover with a total turnover of £18.7bn. The value of each segment has remained broadly static.

Figure 1. Breakdown of market segment by turnover 2012/13



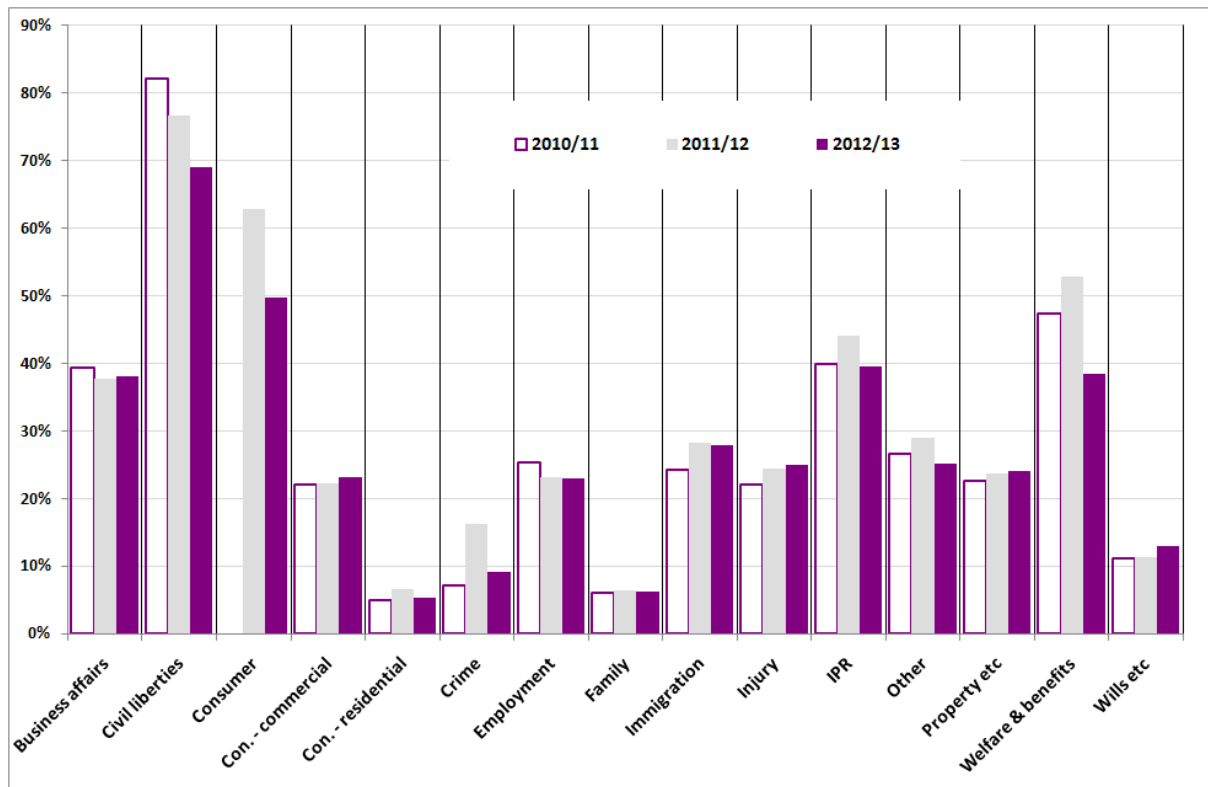
Just half of firms have grown turnover, but levels of unmet need remain similar for both individuals and small businesses

- Out of the 7,457 firms on which data is available, 51% of firms have seen a reduction overall real turnover of between 2010/11 and 2012/13. Nearly a third of firms have seen a reduction of more than 10%. This means that any growth in real turnover is concentrated in just under half of all firms. However, there is limited evidence of competitive pressure yet driving firms to adapt to service unmet consumer legal need, improving access to justice. For example, a consumer facing a legal problem in relation to employment and family during 2009 and 2011 was just as likely to take no action to handle alone as they were between 2006 and 2009. In 2012, just 29% of small businesses sought advice when faced with a legal problem, and only 12% sought advice from a solicitor.

Market shares have changed very little in most segments

- The market share of the top 10 firms has fallen slightly from 19% in 2010/11 to 17% in 2012/13 while the firms in the top 10 have remained constant. The smaller value segments such as civil liberties, consumer problems and welfare and benefits show variability. However, most segments have seen little change in market share, as shown in the chart below.

Figure 2. Top 10 firms market share by segment.



- Further, while the levels of new entrants has fallen – from 10% of all firms in 2011/12 to 5% in 2012/13 – the level of market share has remained constant at

5%. This points to fewer, larger firms entering the market in 2012/13 than in 2011/12.

ABS organisations are starting to have an impact

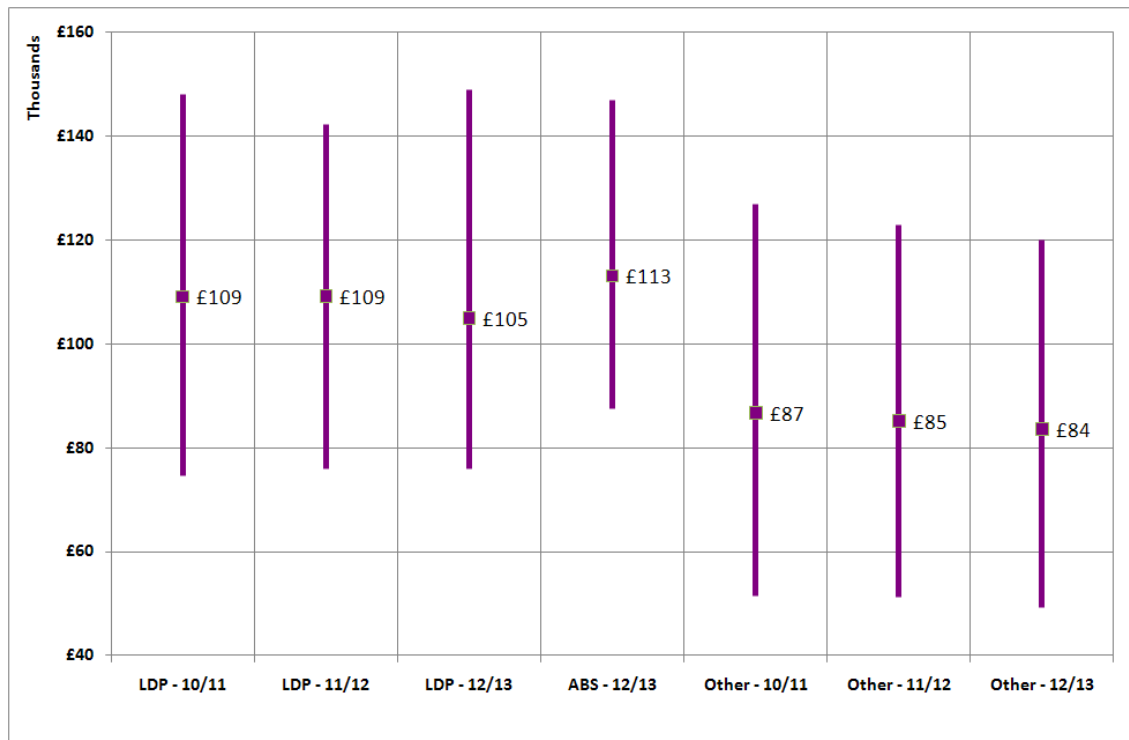
6. ABS organisations, permitted by the SRA since January 2012, are most prominent in the injury segment. As of June 2013, the SRA had granted 155 licences. As a group, they accounted for 20% of market share in the injury segment, compared to just 3.5% of market share in the employment segment. The 20% market share in injury is evenly split between new entrants ABS organisations and existing SRA regulated firms who converted. We can speculate that the concentration on the injury segment is a direct response to the referral fee ban introduced in April 2013, but there is no clear evidence from the ABS survey responses to support this.
7. Based on our survey, while ABS provide services to wide range of consumers, they are statistically more likely to serve business consumers as opposed to individuals. These firms use technology to deliver services to a greater extent than other firms do. In all, 91% of survey respondents indicated having a website that they used to deliver information and other services to their customers. This included basic information, online case tracking and feedback systems. This compares to just 52% of other solicitors firms having a website they used for advertising, and 6% using legal networks websites.

New business structures have increased market share over the past three years

8. Legal Disciplinary Practices have been permitted since 2009. Over the past three years, while this group of firms never represents more than 5% of the total number, they accounted for 14% of all market share in 2012/13. Further firms who were LDPs in 2012/13 were statistically more likely to have seen an increase in turnover in the past three years – 57% compared to 49% for all providers. ABS organisations had 5% of total market share in 2012/13.
9. Looking at the market segments in which these firms operate shows that this group of firms are over proportionally over represented in each of the segments – have greater market share than their number would suggest – except for consumer problems. This group of firms nearly a fifth of the market in the civil liberties, commercial conveyancing , employment, other, property, and welfare market segments. This broad spread is in contrast to ABS licence holders concentration in the injury segment.

New business structures are more productive

Figure 3. LDPs are consistently more productive than other firms – turnover per fee earner



10. Levels of productivity, as measured by turnover per fee earner, for LDPs are consistently higher than other types of firms over the past three years. ABS organisations had the highest productivity of all types of firm in 2012/13.

New business structures are better at resolving complaints about service

11. Reported complaints received, resolved, and referred to LeO compared to turnover show that LDPs and ABS have better complaints resolution ratios. ABS resolved 11 complaints for every one referred to LeO. For LDPs this was 5, and for other solicitors firms this was 4. Further, LDPs generated the highest levels of turnover per complaint – and therefore receive the lowest number of complaints when their size is taken into account. In 2012/13 LDPs generated £7m in turnover for every complaint referred to LeO for resolution, compared to £4.3m for ABS and £4.5m for other solicitors firms.

Innovation is most prominent in ABS firms and large solicitor firms

12. A 2009 NESTA investigation into innovation in a range of professional service sectors surveyed found that innovation in legal services was among the lowest. They found that the largest firms were significantly more innovative than smaller ones, especially in the marketing and organisational dimensions of innovation.

13. A review of reported innovations over the past three years found that ABS organisations were associated with more frequent reports of new innovations when compared to other SRA regulated providers. Around 13% of ABS organisations

introduced an innovation not related to their organisational structure. Just 1% of other SRA regulated organisations reported any form of innovation. These organisations were mainly providing services to business consumers, and tended to be larger firms.

Regulation is still reported to be a significant barrier to innovation and growth

14. NESTA reported in 2009 that respondents felt the main barrier to innovation was cultural – conservatism was a major constraint on innovation in legal services. They concluded this was driven by regulation.

15. Respondents to our 2013 survey of ABS organisations saw regulation (43% of SRA regulated ABS licence holders) and the traditional partnership model (41%) as key barriers to innovation and growth. However, another key issue reported was the uncertainty of future laws and regulation - 47% for SRA but just 8% for CLC regulated respondents.

Figure 4. ABS organisations views on main barrier to growth and innovation in legal services

ABS survey respondents	CLC Regulated (n =13)	SRA Regulated (n=49)	All (n=64,N=193)
Access to capital – banks won't lend	15%	39%	33%
Traditional partnership business model	31%	41%	39%
Lack of information on how to innovate	0%	10%	8%
Consumers like traditional services	23%	12%	14%
Existing regulation	15%	43%	39%
Uncertainty of future laws/regulation	8%	47%	38%
Other	8%	8%	8%

16. While 86% agreed or strongly agreed with the statement that “*Complying with legal services regulation adds significant costs to running a business*”, 78% agreed or strongly agreed felt that “*legal services regulation reinforces best practice and good management*”.

Context

17. At the LSB we are keen to ensure that the rationale for the regulatory reform is not neglected. The LSA gives each approved regulator, OLC, and the LSB a legal duty to as far as is reasonable practicable of delivering the regulatory objectives. As part of ensuring this happens effectively we undertake work to monitor and report on how the reforms are impacting on the legal services market.

18. Following on from our markets impacts baseline report in 2012 looking across all the regulatory objectives, our analysis this year focused on the regulatory objective of ‘*promoting competition in the provision of services in the legal sector*’. This analysis focuses on changes in the supply side on the assumption that the supply side will respond more quickly than consumers, and these changes are more

quickly observed than changes in consumer behaviour. Also, real market outcomes – falling prices, increased quality, and greater access – will take some years to identify. We focused on SRA regulated firms because:

- This regulated community has seen the most change in the past three years, with the BSB only recently changing regulations to enable direct access on a significant scale; CLC and the Intellectual Property Regulation Board (IPREG) focusing on a few specific segments; and other approved regulators yet to regulate any entities
- The SRA regulate by far the biggest part of the regulated legal sector on any scale
- The SRA have good regulatory data increasing the objectivity, scope, and usefulness of the analysis
- Recent research into solicitors firms funded by the MoJ, the Law Society, and the LSB enables us to understand the drivers for change in the composition of supply in this sector.

19. The analysis utilises Competition Commission guidance for conducting investigations into competition, and the Oxera framework for monitoring the legal service sector, commissioned by the LSB in 2011. The analysis looks at outcomes not inputs. For example we do not look to assess the SRA ABS application process, but look at the type and range of ABS organisations that have entered the market or changed their structure. We also use research commissioned by the LSB to understand how consumers respond to legal problems, interact with legal services, and more specifically with solicitor firms. Finally we undertook a survey of ABS licence holders, and use the responses to enhance our analysis.

20. The analysis looks at:

- Changes in market concentration, and rates of entry into different market segments;
- Changes in firms business structure, focusing on the new business structures; and
- Changes in the levels of reported innovation, and views on barriers to growth and innovation.

21. This evidenced based approach is designed to challenge often untested assumptions made about the legal services market, and push the cultural change necessary to deliver the regulatory objectives envisaged by Parliament.

22. The analysis shows new business structures starting to increase competition in some segments but not yet in others. Further real turnover has fluctuated between +/- 1% of 2010/11 levels, despite a greater proportionate fall in the number of law firms overall. The full report and analysis is due to be published on the LSB website in October 2013.

