Conference of Regulatory Officers, Perth, Australia

Oversight regulation in the UK – Rationale, Progress and Challenges

Introduction

I have already thanked the Legal Practice Board of Western Australia for the opportunity to take part in this conference. May I now follow other speakers in thanking Robert Isaac for his inspiring welcome and in acknowledging the traditional owners of this land and expressing my respect for their elders, both past and present.

It's a great pleasure to have been invited here to update you the changes in regulation of lawyers and the legal market in England and Wales. My only objection to CORO is that I've heard rather too much of my own voice in it, but I've been given a lot of food for thought from colleagues as well.

And that continues a tradition in recent years. The UK learned from Australian experience, particularly Steve Mark's, in relation to Alternative Business Structures, in making those changes. In turn, I hope that some of the experience of how those changes are taking shape can now contribute to your own thinking and to the debate in the Attorney General's taskforce on the future of legal regulation in the commonwealth.

And that cross fertilisation isn't surprising. Clearly our two jurisdictions have a lot in common, both in history and values. We both operate an adversarial legal system and judgments made in the courts of either country are persuasive in the other. There's ready interchange: I sometimes believe that there can't be a single antipodean lawyer between the ages of 25 and 30 in Australia or New Zealand as there are so many in London. And we've had reference to corporate partnerships as well. But, above all, the importance of the rule of law, as well as the need to ensure that access to justice is as wide and as real as possible, drives regulatory thinking for us all.

The challenge for regulation strategically, however, has been whether that focus on the rule of law is enough on its own, or whether it can be supplemented by broadening the range of regulators' reach into other issues as well. Developments in legal structures here show Australia to be ahead of the game internationally in recognising that legal regulators have a role in furthering the consumer as well as the citizen and public interest, not least by fostering greater competition

If anything, the UK has now gone further, by giving my Board and the regulators we oversee, a combination of traditional professional regulatory and competition authority-like functions and giving us the challenge of discharging both sets of responsibilities in the widest possible definition of the public interest. Obviously, as Chief Justice Martin's very stimulating talk highlighted, there can be tension between these goals. But it's our task to make that tension creative and put ourselves and the profession and industry in the UK where it delivers BOTH/AND – both the highest ethical standards and the maximum consumer benefit, rather than having to make an Either/Or choice. That's tough. But not impossible.

Background to the reforms

Why reform in the UK ? For better or worse, public confidence in wholly self-contained self-regulation had gone by the beginning of this decade. What gave rise to this? Well, a government report in 2003 called the system "Outdated, inflexible, over-complex and insufficiently transparent or accountable". Let me unpick that a little more and offer 7 reasons:

- ***Ineffective routes to consumer redress***

In the context of complaints, complaints were seen to be handled too slowly and not effectively enough.

- ***A lack of consumer focus***

More widely, in delivering services, there was no obvious focus for ensuring that the regulatory bodies were building consumers' interests into their policy, not least because of a lack of lay involvement in the regulators themselves. Adding 4 lay members to a Law Society Council of over 100 was, to put it politely, seen as just a little tokenistic.

- ***Representative/regulatory tension***

Most seriously, people outside the legal profession found it puzzling that a body like the Law Society could on the one hand represent their members whilst also simultaneously acting as their regulator. How could they be a passionate advocate for the profession whilst also being a dispassionate regulator?

Perception is as important as reality when it comes to consumer confidence in lawyers. The legal services sector differs from many others in that it brings together both consumer and citizens' concerns. One of our Ministers got into trouble for saying that it ought to be as easy to purchase legal advice as it was to purchase baked beans. Now that statement is obviously incomplete. But it's not wholly wrong. Legal advice and representation is as much a commercial service as any other. However, like some others such as financial services, it also concerns issues of major public policy interest like fairness, freedom and reputation and the even more fundamental one of the rule of law. Because of this, confidence in lawyers is both a consumer matter and an essential public interest. To the extent that commercial self-interest – rightly or wrongly – is seen as an issue by the public in relation to regulation, that's a regulatory and public policy problem.

- ***Complexity***

The multiplicity of regulators created a maze of regulation that fuelled a sense of remoteness from consumers. Most people hope never to have to engage in legal processes, but when they do, it is often at the most vulnerable times in their lives. Clearly, for individual consumers, signposts, information and quality assurance are crucial when dealing with lawyers. Yet individual and business consumers both felt unable to navigate that complex maze of regulation.

We now have 10 approved legal regulators in the UK – divided by the part of the market that they oversee rather than by geography. The challenge is to make the public – consumer, citizen and business – aware of what they do and to give them justified confidence that it's being done well. Differing remits and objectives got in the way of that surely self-evident aim.

- ***Lack of coordination***

Complexity had an operational impact as well – it meant that good practice in one arm of the profession was not being shared with the others. And professional regulators tended not to learn from success or failure in other sectors. So the energy and networks to drive change, for example on issues like access to the profession and diversity, emerged slowly or not at all.

- ***Barriers to competition***

Alongside these concerns, opportunities both for lawyers and consumers were being missed. Neither government nor competition authorities saw legal services as above scrutiny. And rightly so, I think. It wasn't a case of mandating new business models or backing winners. But regulatory barriers do need justification. One of the few areas where I disagreed with Justice Martin was in his comments on restrictions on barristers entering partnerships. And I disagreed, not because the risks he identified don't exist, but because they would only eventuate if there is a wholesale change from one model to another, which frankly seems highly unlikely given the independent – and frankly disputatious – mindset of many barristers I know! So it's important to justify putting a restriction on how anybody practices his or her trade – and I'm not sure that hypothetical arguments which depend on the wholesale collapse of a strong and valued business model, which should weather fair competition and emerge stronger from it, really meets the necessary high test to do so.

- **Access to Justice**

And finally there is real concern about access to justice. No jurisdiction is at present able to sustain large increases in legal aid funding. But there is no doubt that many people – above benefit levels and therefore never likely to be eligible for state support – find the cost of legal services a real barrier. Many people have a real fear that they will find themselves on the wrong side of the classic legal joke:

"What will you do for £500?"

"Answer three questions. What's the second?"

So one of the motivators of enabling the introduction of new business models is to

help alter incentives in the market to enable those people to be served.

Some in the UK have argued that new business models damage access to justice by threatening small practitioners. I'm not sure other markets bear out those prophets of doom – insurance brokers have survived the threat of internet sales by upskilling and selling higher value services, for example. But, more fundamentally, I would argue that far from being a threat, enabling competition and enabling new forms of properly regulated business, is the best way the state can ultimately enable access to justice.

Reform through the Legal Services Act

The combination of these concerns gave rise to calls for a major reform of the regulatory structure. The question was how to steer those reforms in a way that had an impact across all parts of the profession and industry, whilst also protecting those core concerns about independence.

Government took the view that it would steer a 'third way' between allowing self-regulation to continue and creating a major new super-regulator in the sector along the lines of the Financial Services Authority – 2,000 + people, £100m + budget .

The result, created through the Legal Services Act 2007, was the Legal Services Board, with a staff of around 35 and a budget of around £4.5m funded by, but wholly independent of, the profession. Because of this, a constant driver is the need to demonstrate value for money for those we regulate. Adding the running costs of the OLC and we are still less than 0.001% of the turnover of the sector – so I reject suggestion that the "English model" is somehow burdensome for the profession.

The model of regulation over which it would preside was to be one of oversight regulation, operating independently of the Ministry of Justice but driving progress alongside the existing regulators to achieve a shared set of statutory objectives. These include protecting consumers, enhancing access to justice and the rule of law, ensuring a strong, diverse, effective and independent profession (and each adjective is equally important to us), boosting levels of competition, enhancing public legal education and promoting professional principles. The Act set out those out, but it is for the LSB, together with the existing regulators, to identify the means.

For the existing regulators, the Board's autonomy has been to be a major plus in allaying concerns about the independence of the legal profession. We have a clear agenda but we are not remotely subservient to government in how we do that.

We've set out our vision in the Business Plan and I'll quote it in full

" We will reform and modernise the legal services market place in the interests of consumers, enhancing quality, ensuring value for money and improving access to justice across England and Wales"

That vision drives an active agenda for change, not a reactive policing role. And an agenda that embraces all aspects of our objectives.

In making that happen, the Board needs to act in collaboration with our colleagues in the Approved Regulators – driving change in partnership but certainly not 'reinventing the wheel' in areas where good work is already being done. We will build on the best of what has gone before. But we will also be fearless in acting where there are shortcomings and where the needs of consumers are not being sufficiently met.

But what we won't do is fetter their discretion unnecessarily by generating a detailed meta-regulatory rulebook. Our approach will be to specify outcomes and principles, to move to detailed rules only where we think that the risks to the regulatory objectives are such that only one solution is possible and to offer guidance, but being cleared that, while that offers a route to safe compliance, it is not the only way.

We take this approach for four reasons:

- First, we are under a statutory duty to be proportionate. They won't thank me for the comparison, but, with the Approved Regulators in place, it would be foolish for us "to keep a dog but bark ourselves"

- Second, it really is about partnership and creativity. If there are different ways to achieve an outcome, why should we outlaw any of them ? How will we or anybody else learn which is most effective if we do?

- Third, there is a useful paradox that the fewer detailed rules are in place, the more encompassing and effective regulation can be. As has been discussed earlier in the conference, it's far harder to wriggle out of a strong ethical principle than to argue up to and beyond the level of an individual provision. And we want to encourage a similar focus on principles and outcomes in the Approved Regulators too;

- And finally cost. We are serious about not wanting to expand beyond our present size. That means enabling the Approved Regulators to do more. And they have the incentive to rise to that challenge to ensure that we don't fetter their discretion on how to do it, or in extremis, take over their functions if they fail.

A few words about constitution. The Board has both a lay chairman and a lay majority. The Chairman, David Edmonds has a background that combines work in financial services and housing, with experience of the highest levels of the civil service, regulatory leadership in telecommunications and broadcasting markets and chaired NHS Direct, the UK's web and phone based health advisrory service. He brings a record of challenging orthodoxies and driving change.

The Board's members also include skilled professionals from within the sector to bring specialist knowledge of the conditions facing practitioners. But, absolutely vitally, there are there as individuals, NOT representatives.

Alongside this, working in parallel to the Board will be a Consumer Panel made up of experts in promoting the interests of consumers. Its chair, Dianne Hayter, has worked at a senior level across a number of regulatory bodies, including the Pensions Regulator and the Financial Services Authority and has expert knowledge through having acted as chair of the consumer panel of the Bar Standards Board. Her panel will apply rigorous scrutiny to the Board's regulatory policy work to ensure that the consumer interest concerns are kept centre stage at all times.

The LSB's business plan sets out a solid programme for achieving our vision. In it we set out a clear picture of how we will aim to change the deal for consumers and lawyers alike by 2013. Again let me quote verbatim:

In preparing this Plan, we have developed a vision of the way in which we want to see the legal services market deliver for consumers in five years time. Its components are simple:

• greater competition in service delivery and the development of new and innovative ways of meeting consumer demand;

• a market that allows access to justice for all consumers, in particular bridging the divide for those whose incomes exceed legal aid thresholds but fall below the level required to purchase essential legal services;

• empowered consumers receiving the right quality of service at the right price;

• an improved customer experience with swift and effective redress if things go wrong;

• legal services professions which are as diverse as the community they serve and which constantly strive to improve standards of practice, quality and education; and

• certainty and confidence in the regulatory structures underpinning the market.

We believe that current market challenges make achieving this vision a higher priority than ever for both the professions and consumers

But within that we have also specified our early policy priorities and we are well on the road to delivering them.

<u>Policy priorities</u>

Our four immediate priorities are:

- Giving consumers more choice and lawyers new business opportunities by opening up the market and increasing competition to allow new types of legal business to emerge;

- Reassuring the public about the rigour and independence of legal

regulation to maintain clear independence from both government and the representative interests of the profession;

- Better consumer redress when things go wrong through a new independent ombudsman for complaints, ensuring a fair, effective and rapid resolution for everybody concerned- I'll happily answer further questions on this, but won't duplicate my remarks of yesterday.

    - Developing a methodology for reviews of individual regulators to raise all regulatory performance to the level of the best, learning lessons from other sectors.

<u>Opening up the market</u>

Prior to the passage of the Act, it was taken as axiomatic in the UK that lawyers and non-lawyers - or even different types of lawyer - should not be allowed to enter into partnership to offer shared services to consumers. This meant that lawyers were unable to create new business opportunities across multiple services – for example through legal services being offered alongside accountancy, tax or insurance services – or offer customer a "one stop professional shop". Nor could they always reward and retain their best non-legal staff as they wanted to – and get them to carry appropriate risk as well!

Despite the Chief Justice's reservation, I don't think that this type of restriction does stands up under policy scrutiny. Clearly there are things only lawyers can and should do – but managing and owning law firms isn't one of them. And it's hard to see why lawyers should be restricted in their ability to show commercial imagination – subject to the proper regulatory controls.

The framework has become more flexible already, with the introduction of LDPs enabling non-lawyers to enter partnership and restricted non-legal ownership of up to 25% of a firm's equity. And we see imaginative use of partnership between lawyers, with patent attorneys entering the partnership of "silver circle"firms and legal executives moving into partnership in firms with heavily commodotised

business models.

But we expect to go further. The full ABS regime will permit full external ownership and outside investment. The LSB now has the power to permit Approved Regulators like the Bar Council and the Law Society to become licensing authorities for entities operating under the Alternative Business Structures regime. We hope that they will apply. But our tests will be crystal clear about removing current restrictions before we agree that they can discharge this responsibility.

What will this mean in practice? It means that non-legal firms can, for the first time, offer legal services to their customers in a way that is integrated with their existing services. And that law firms can develop their portfolios to compete aggressively from their existing experience. Let's be clear. The market will not be rigged. We will enable ABS firms. We won't promote them. ABS will not be a "public interest-free, consumer protection lite" regime. But nor will ABS firms be burdened with requirements that are not clearly and transparently risk based. If the risks are different, the regulation will be different and proportionate to the risk. If the risks are the same, the regulation will be identical.

We believe that the very ability to enter the market will make it work more effectively, even if there are comparatively few new entrants in the short term. The scope to increase the choice available, the fact that the prospect of higher levels of competition may provide both better value and help to provide better incentives for quality practice. Perhaps even more importantly, the new freedoms will spur on innovation in the market as businesses seek to build new business models that stretch across a range of services aimed at consumers. This is not just good news for the consumer; it's good news for lawyers as well.

This comes at an appropriate time – the economic climate means that all sectors are looking for new sources of capital and new commercial opportunities. For the legal sector, the flexibility offered by ABS provides a real platform for innovation.

The recession makes the case for change, not the case for delay. Ostriches don't survive downturns.

That's the policy behind ABS. We have consulted extensively on our initial thinking published in May and there are some interesting responses on our website as well as the document itself. Later in the year the LSB will be publishing further thinking on how the rules governing this area of work will look. Specifying how the fit and proper person test will work, identifying how the Head of Legal Practice and Head of Finance and Administration roles will protect standards and viability will be key. As Steve Mark and Andrew Gretch hinted yesterday, these are specific new statutory roles, which give greater certainty about corporate governance and regulatory compliance than are demanded of firms currently. So, far from weakening incentives for compliance, the new regime strengthens and personalises responsibility more than ever before.

We hope to see the first ABSs in place from 2011 and a number of major and recognisable brands are already drawing up plans on the kind of services that consumers can expect to see. Proportionate regulation is the aim. That does NOT mean deregulation. Concerns over quality and access to justice must underpin our approach at all times. But this is an area where good regulation can align professional and commercial incentives to ensure the right outcome.

<u>Regulatory independence</u>

The second major focus for the Board's early work is regulatory independence. Already we have seen moves forward in this area as the representative and regulatory arms of the Approved Regulators have begun to separate but have not yet had a clear statutory specification for doing so. This is a key area because a crucial driver of the reforms has been to end any perception that regulators

operate in the interests of regulated parties rather than in the interests of the wider public. It is about ensuring that regulators of all lawyers operate in a system of constructive challenge both from within and outside the profession, and in a system in which professional ethical standards are rigorously upheld.

The more robust the framework, and the more effective its implementation, the less chance there will be that the LSB will need to intervene. This goes to the heart of our approach of proportionate regulation. We're not about the oversight regulator creating its own locus for action; it is about acting as a check, on behalf of the consumer and citizen, on the capacity of the existing regulators to effectively regulate their own arms of the profession.

This area offers a real demonstration of how the model of oversight regulation can drive change sensitively and proportionately. We recognise that one size will not fit all. What will be right for the bigger regulators will not necessarily be the right approach for some of the smaller bodies. As I've said to some of you, the smallest body we regulate has a turnover less than my salary, whereas the Law Society is, in the nicest possible way, easily big and ugly enough to look after itself. So, in building that framework we will adopt a proportionate approach body-by-body that enshrines independent regulation not only in actuality but also ensures the perception of independence at all times. Consumer confidence is a key end result, so we expect to ensure both that the necessary safeguards are in place and that they are clearly communicated.

We yesterday published the near final draft of the rules to give effect to the necessary changes. We're dealing with such issues as the composition and appointments of regulatory boards – where we are insisting on a lay majority on boards, but not going as far as some consumer bodies would have wished and mandating a lay chair. We're also dealing with how those boards are funded and supported to make sure that they have the resources and skills they need, at the

level they need, when they need them – we're building a system that prevents the representative arm of the profession strangling the regulatory arm, while also making sure that the regulatory arm has to show proper budgetary discipline. We're explaining how bodies with dual regulatory and representative functions can have corporate oversight of regulatory functions without fettering independence and setting a timetable for how we as the oversight regulator will approve the arrangements case by case.

Those who have followed the consultation on our website will see that we have picked up many of the helpful proposals put forward. And we think the blueprint we're now offering is both pragmatic and principled – not least in its clarity about outcomes, but its flexibility and comparative absence of detailed rules to give individual bodies flexibility.

Complaints handling

I talked about this yesterday and will should first reiterate my belief that, in the UK context at least, it makes little commercial, regulatory or consumer sense to run all disciplinary and customer care complaints through the same system. Standards of proof are different, confidence is undermined if a disciplinary process is, in the interests of justice, fairly elongated and leads to a "therapeutic" intervention when there is a clear need for early redress for the consumer. There are overlaps, there must be good communication, but a single mega-system will serve neither profession nor public.

Prior to the legislation, concerns were raised across consumer organisations that complaints against lawyers, especially solicitors, were not being dealt with quickly or fairly. Several reviews of the existing arrangements and a discrete regulatory regime made some progress in rationalising the system of complaints handling, but never succeeded in gaining public confidence.

The solution put in place by the Act was to create the Office for Legal Complaints as an ombudsman service for all customer care complaints. It formally came into existence on 1 July this year and we hope will receive its first complaints towards the end of next year. We believe that the Ombudsman model – quick, impartial, disinterested with the focus on dispute resolution, not legal analysis – is the right way to solve consumer problems quickly – and ensure that the regulators can focus more quickly on the serious business of professional discipline.

The Chairman of the Office , Elizabeth France, was the UK's first Data Protection Registrar, first Telecoms Ombudsman and first Energy Ombudsman. The Chief Ombudsman, Adam Sampson brings with him a record of campaigning for vulnerable people as Chief Executive of the national homeless people charity Shelter, as well as specialist knowledge from inside the sector as a former Assistant Prisons Ombudsman. We can rely on them to fairly balance interests – and to ensure that learning from his team's decisions is fed back to industry, regulators and consumers alike to build knowledge and improve services.

I should also say that the OLC has just begun its consultation on its scheme rules and now has its own website to enable you to track developments.

Regulatory Reviews

This is an area where we have done less work, but one where we want to force the pace in coming months. We have a sister body – the Commission for Healthcare Regulatory Excellence – which oversees health professional regulators in the UK in much the same way that we do legal regulators, albeit without the remit to press home competition. We believe that their name and the system they have for regular reviews of the governance and performance of the bodies under their wing offers a good model for assessing performance, spreading best practice and, where necessary, offering constructive challenge to legal regulators.

We will want to look at both performance in core day-to-day regulatory work, of the kind we have been discussing through this conference and, more difficult but also arguably more important, looking at their capacity to develop and grow in addressing the regulatory objectives. We want the regulators to get into the mindset that changing and adapting to market conditions – and to shaping those conditions when that is justified – is as important as running a slick administrative organisation. We see this as a collaborative endeavour, about raising standards across the board, not as a disciplinary one and, as I have emphasised on numerous platforms in the UK, aiming for excellence doesn't mean expensive scatter gun activity – gold-standard does not mean gold-plated.

Conclusion

The programme for the LSB is one that is unprecedented in our sector and is a major turning point in the delivery of legal services in England and Wales.

The sector has not experienced this model of oversight regulation before and the interplay between the LSB and the Approved Regulators is being forged as an entirely new set of relationships. The fact that we have the same set of regulatory objectives makes us confident that we will not often come into conflict – but we will use both our influence and, where we have to, our statutory powers if regulatory failure becomes evident.

We hope that will not happen. The more that it does, the more the possibility of the large mega-regulator will return to the debate. And that seems bad news for the taxpayer and the profession, with less chance of the right balance between consumer and citizen issues being achieved, and real as opposed to hypothetical threats to the independence of the profession .

The Board's work takes place in a sector that has a great deal to be proud of. Its traditions and history offers a rich source of experience on which to draw. However, the perceptions of a lack of consumer focus that drove the reforms were real. Whilst building on what has gone before, modernisation demands that the regulatory framework enshrines both new commercial freedom and new consumer protections on the one hand and timeless principles of ethical conduct on the other. They are two sides of the same coin – not opposing forces. I think that we can manage any creative tension between them.

I'm grateful for colleagues here for contributing to our thinking on how best to do this and I hope that my thoughts may be of help to you as you face your own reform process. Long may our partnership continue!