GETTING THE INCENTIVES RIGHT

Westminster Legal Policy Forum

Alternative business structures and the legal services market - impact one year on and future challenges

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18 October 2012

The most memorable speeches and phrases supposedly come in sets of three. "*I came, I saw, I conquered*". "*Friends, Romans, Countrymen*" or, to be more modern, "*Education, Education, Education*". So I thought that I would try to follow that rule in this speech without turning it into Monty Python's version of the Spanish Inquisition, where three deadly weapons rapidly turn into four, then five and then spin out of control.

So, I am going to talk about three sets of three points:

- First, three areas of real progress - ambition, independence and data;
- Second, three challenges – reforming rule books, improving supervision and stripping out redundant processes;
- And finally, three ways in which the LSB will help delivery – restraint, focus and performance challenge.

Let's look at the three areas of progress.

First, more ambition. Legal Services regulation is increasingly about enabling change in the market. Not specifying change, not seeking to control it or limit it, but removing obstacles to innovation and maintaining essential consumer protection and public interest safeguards.

That is a long way from the historical model of professional registration, curriculum control and occasional disciplinary action when the rules of the club were infringed.

The Legal Services Act marked a decisive break from that tradition. Some of the most interesting innovations we are seeing at present could actually have been established

without the legislation. But it needed the cultural and competitive changes triggered by the Act to make it happen. So the Act isn't a matter of one large project implementing the single large idea of ABS. ABS and regulatory reform are means to the end of a more responsive market, not ends in themselves.

Second, independence. The trade press shows on a daily basis that accusations of regulators being in the pocket of professional bodies are very far off the mark. Contrary to what some have said, it is equally far off the mark to call the LSB a "creature of government". We are a creature of statute, independent of both Government and those we regulate. We will remain that way.

Regulators have achieved independence in strategy setting and operational decisions. But independence also means ensuring that the resources - cash, systems and people - are there to enable regulators to do their job. Of course, there should be robust challenge from professional bodies – and indeed their individual members, consumer bodies and other stakeholders. The regulatory performance data to enable that to happen needs to be a matter of public record for all parties. But that is a challenge function, not a control one. And the LSB will not allow it to become one.

There is more to do. Getting structures right doesn't of itself produce proper behaviour or eliminate all tension. The public rightly expect regulation to be independent of all vested interests.

I'd suggest that this means regulators that are – and are seen to be - very clearly led by the public rather than the professional interest. Independence from the professional body is necessary for this, but may not be sufficient. Do regulators make as much effort to engage consumer groups as professionals, for example? Do they worry about the "brand" of their parts of the profession, rather than leaving that to professional bodies? So there is progress, but further to go.

Third, better data and evidence, less assertion and anecdote. I am genuinely proud of how we have led the way. Our regulatory information review has developed a baseline against which changes in the market can be evaluated. We'll be publishing an updated version next month. But we're also getting to grips with how to measure vital, but too often nebulous, subjects such as access to justice and professional ethics – without relying on dubious opinion polls. Some of the approved regulators are increasingly alive to their own need for similar analysis – and the LSB will continue to challenge proposals which lack this underpinning.

Now, three challenges in making the benefits of outcomes focused regulation real for both firms and consumers.

First, getting the rule book right. OFR should mean more innovation, greater choice and better value. It should make it easier for firms and chambers to provide information when customers and clients want it, in the form that they want it and, increasingly, at a price they can afford. Regulation hasn't talked about access to justice in the past. At worst, it's even been one of the obstacles – now, it's a force making it happen.

Above all, outcomes focused regulation is about treating lawyers as responsible ethical professionals and firms and chambers as grown-up businesses. In other words, regulators need to be clear about what legal services are there to secure for the citizen, to set the minimum standards to protect those outcomes and then set professionals free to achieve them.

So focusing on outcomes means fewer, but better, rules. Rules which are waived frequently are, frankly, rules that should not exist. Nor should rules that duplicate criminal law: lawyers' obligations to obey the law are no different to everybody else's. They're not so deaf that they need telling twice. If you see a business practice that looks like bribery, call the fraud squad, don't make a regulatory rule.

Second, improving supervision and intelligence. You can't do much targeted regulation if you don't know who is doing what, in what volume and with what systems to underpin it.

Why? Because a focus on outcomes doesn't mean hands off regulation in every case. Regulators need to know the risks that *specific individuals and individual entities* present and then have a range of tools they can apply. Such requirements might be triggered, for example, by the areas of law in which they practice, any oddities in their financial model or by concerns about previous conduct. But the crucial points is that the imposition of additional requirements can be justified by reference to specific data, rather than by a vague general concern about potential threat.

Regulators shouldn't be afraid to enforce when they need to. There are challenges around the architecture and performance of disciplinary and appeal arrangements - it's no secret that the LSB thinks that the present fragmentation of appellate arrangements is confusing for consumers and bad news for the rule of law as well, because of the scope for inconsistency.

There is also continuing debate about the civil versus the criminal standard of proof. I personally think that the Law Commission's support for the civil standard in its report on health regulation which points out that "*the criminal standard implies that someone who is*

more likely than not to be a danger to the public should nevertheless be allowed to continue practicing" is the last word in policy terms.

But supervision, rather than enforcement, is the priority. To overstate only a little, every enforcement action taken represents a failure of supervision. And every failure of prevention means that somewhere, somehow consumers have lost out. So early risk identification and proper supervision to maintain and return firms swiftly to compliance is the key gap to fill.

Third, clear out the baggage. Proper supervision has nothing to do with "regulation by permission" in which you can only act with the regulator's say-so. What is the case now for changes to training contract arrangements needing SRA approval? Do firms that decide to change into LLPs really need permission? Even in looking at ABS, the focus needs to be – and, increasingly is - on ensuring rapidly that fit and proper person tests are met, none of the statutory criteria for refusal are invoked and proportionate supervision can be put in place, rather than seeking to interrogate business plans in minute detail.

So our challenge to regulators will increasingly not be "*Can this process work better?*" Instead, it's likely to be "*Why is the industry paying for such a process at all?*".

That's a significant transition agenda. So here are three things the LSB will do to help to make it happen.

The first point for us is the same as the last for regulators – to stop. We have been accused of initiative-itis in the past. I reject that – we have found too many areas, such as immigration advice, where bland reassurances from regulators concealed an absence of the most basic data.

But, looking ahead, there is nothing to be gained by a multiplicity of action plans and monitoring mechanisms. Increasingly therefore, we will make decisions, for example in our recent statement on quality, which set clear expectations of progress, but give regulators a free hand about how best to pursue that. And we will hold to account through our regulatory effectiveness agenda, rather than ad hoc initiatives.

Second, and related, we will be even more rigorous in our focus on regulatory objectives, better regulation principles and good governance.

The public interest and the rule of law have to be the bedrock tests for any regulator in legal services. But we'll remain focussed on the problem areas - access to justice, consumer and competition issues - which are closely related and often call for the same kind of policy

responses. That's why our proposals on will-writing, for example call for a new settlement to encourage ethical new entry and to give better protection to consumers of unregulated services and also of the existing regulated services, where regulatory targeting is poor.

My third and final point is a triplet in itself – performance, performance, performance. We will be absolutely rigorous in following through on the regulatory effectiveness process. We will be transparent in our assessments, challenging in our expectations on action and driven in making sure that those actions are specific, time-bound, properly resourced and above all delivered.

That same approach will underpin our decisions on designation of new bodies – such as the ICAEW seeking to become a regulator of legal services. It will underpin our decisions in the granting of new rights to existing bodies. I would be surprised, for example, to see us give new responsibilities to bodies which do not demonstrate robust, externally-validated assessments of their own performance.

Legal Services no longer stands outside the better regulation agenda. It's moving from catch-up to the mainstream. Last month's international legal services regulators' conference showed that regulation in England and Wales is, in many ways, already at the forefront. Maintaining and consolidating that position is what all our activity over the next three years will be focused on.

One reason for saying that is that, in three years time, there will be another Government Triennial Review of the LSB and OLC. This year's document rightly said that a future review would be based on a radically different evidence base. By then, there may be a different economic environment. There'll certainly be evidence about how the regulatory changes have impacted on the market and consumers. But an assessment of how well the entire regulatory machinery is working will surely be integral to it.

We have said continuously and I do not apologise at all for repeating here "*how big the LSB is, what we need to do and for how long we need to exist, depends ultimately on the performance of the approved regulators in delivering their regulatory purpose*".

You may think that making the legal services market work better for consumers and citizens is a pretty inspiring mission as it is. But, if the thought of getting the LSB off their backs also inspires front-line regulators to work better for the citizen and the consumer, so be it. Good regulation is, after all, about getting the right incentives in place.

Thank you.