"Legal services regulation: past, present, and future"

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It's not always a good thing to dwell on the past.

Shakespeare wrote "*what is past is prologue*".

But it sometimes is necessary to spend a little time there just to remind ourselves of exactly how things were, what they are like today, and then how we might continue to move forward.

I've been reflecting on this as I start to enter the last few months of my tenure at the LSB.

Let me start with Sir David Clementi and do a quick assessment of progress.

His report in 2004 described a significant sector of the UK's economy where competition, innovation and a focus on the consumer interest as we know it did not exist.

He said that "*the current legal system is flawed. In part the failings arise because the governance structures of the main frontline professional bodies are inappropriate for the regulatory tasks they face'*.

Less so than previously perhaps, but far from sensible.

A further cause is the over-complex and inconsistent system of oversight regulatory arrangements for existing front-line regulatory bodies".

Well, we do have the supra-regulator - the LSB.

But have we had the tools we need to do the job properly?

He added that "*There are no clear objectives and principles which underlie this regulatory system; and the system has insufficient regard to the interests of consumers. Reforms have been piecemeal, often adding to the list of inconsistencies. The complexity and lack of consistency has caused some to refer to the current system as a maze*".

My Chief Executive is on record as saying that the maze was replaced by a three-dimensional labyrinth. Who am I to disagree?

Turning to complaints he suggested that "*at an oversight level, there is a concern about the overlapping powers of the oversight bodies; and at a level of principle, there is an issue about whether systems for complaints against lawyers, run by lawyers themselves, can achieve consumer confidence*".

The Legal Ombudsman faces challenges – but it's being there is undoubtedly a big step forward.

And finally he focused on the restrictive nature of legal business structures at that time.

He argued that business practices in the legal sector had not kept up with other sectors and asked whether "*the restrictive practices of the main legal professional bodies can still be justified, in particular those which prevent different types of lawyers working together on an equal footing*".

I understand the tactical reasons for Clementi's caution at the time, but the truth is that ownership of law firms was denied to the 99.9 percent of the population not in the brotherhood.

Removing restrictions on different parts of the profession was a very tentative step in tackling that.

And, if I'm proud of one thing that the LSB has done in my time at the helm, it has been rapidly accelerating that timetable for delivering external ownership and driving the innovation from both new entrants and existing players that legal consumers have long needed.

But let's unpick the story in more detail.

Did Clementi lead to an updated, flexible, simple, accountable and transparent regime?

No. What actually happened was a regulatory regime based on 400 pages, 214 clauses and 24 schedules of the Legal Services Act 2007...

When Jack Straw was interviewing me for the role of Chairman of the new oversight regulator – the Legal Services Board – he asked me what I thought the main problem would be.

My answer was quite simple – I had a copy of the Act which I dropped on his coffee table with the reply – "*Trying to make this work*".

The Act took this form because as it passed its various stages, lobbying (by the many parts of the legal profession in particular) added complexity and qualification.

This has made infinitely more difficulty the delivery of its overall goals (i.e. the promotion of consumer interest, competition, innovation and transparency).

But the priorities, set out in the eight regulatory objectives – *public interest*, *competition*, *the consumer interest*, *a strong and diverse profession and workforce*, *promoting professional principles*, *public legal education*, the *rule of law* and – paramount in my personal view though we have never set out a single hierarchy – *access to justice* – remain the right ones.

The real issue is both a fundamental constitutional issue and a simple market economics issue.

Access to justice is what makes rights real.

It ensures citizens can play a useful role in civil society and supports small and large business trade with confidence.

It is the embodiment of the rule of law in practice, not just in terms of dispute resolution but in providing the foundation for the very nature of society and economy.

As such, the failure of the legal market – or the legal profession as many prefer to call it – is to innovate to meet the huge latent demand among individuals and small business that is our access to justice crisis.

Let us not avoid the issue.

So how or what has the LSB done to meet this challenge?

My hypothesis is that the LSB has done a very substantial job in delivering the priorities of the Act.

But we could have gone further and faster with better tools.

The strains in the current settlement are beginning to show.

Let's look at the positives first. Since April 2008, the LSB has delivered:

- early – both its initial establishment and the delivery of ABS happened considerably ahead of the timetable initially set out by Government

- below budget – set up was achieved below budget and in its almost four years of operation, the Board has both lived within the initial cost estimate and has not only never sought a cash increase in its running costs but has consistently managed to press costs down within each year and from year to year

- comprehensively – we have delivered a challenging three-year plan for the period 2009-12 and the first year of the next three year plan 2012-2015 in full.

There has been a major shift in the way regulation is carried out detached from the special interests of the professional bodies.

If arguments between regulators and professional bodies were to be the key performance indicator, we'd be hitting every target.

Instead, I find it rather dispiriting to see how much effort is wasted in the frictional costs of arguments within the complex system that we have.

But the independence of regulators from professional bodies – if not always the profession – can't be gainsaid and does represent real progress.

We have set up a fully functioning complaints resolution body.

It is dealing with around two thirds of the complaints that the old system had to deal with at around half the cost.

There is also evidence that complaints handling is improving on the front line as well. Debates about how to implement the European ADR directive might also provide more opportunities.

Nearly 250 ABS now exist (247 as of 05/12/13) with over one hundred more in the pipelines.

More has been delivered then even the most optimistic thought was possible.

We're seeing entry from big name brands, the development of subscription services for SMEs, much more effective IT deployment and – at very long last – the development of proper multi-disciplinary practices to enable coordinated advice to business and consumers – all underpinned by increased professionalization (in the good, rather than exclusionary, sense) of law firm and Chambers management.

Other things have happened as well:

- we've approved significantly slimmed down rule books for the BSB and the SRA (circa 500 pages down from 700 plus pages) but with much further to go

- we've developed an approach to the performance assessment of regulators and assessed each one of them against it. All have challenging plans in place and many are making strong headway against them. We have been particularly impressed recently with the progress of the Bar Standards Board in this area

- we're pushing for more flexible models of legal training and education to prepare lawyers and others for the new legal market. We stimulated the establishment of the Legal Education and Training Report which has already led to fresh thinking among its commissioning bodies and educationalists, and

- I'm particularly proud of what we have done to produce better data and evidence, less assertion and anecdote. But we are getting to grips with how to measure vital such as access to justice and professional ethics, we've developed a baseline against which changes in the market can be evaluated and have started to show how regulation of the legal market can learn from developments elsewhere, rather than starting from a position of repelling all boarders.

Yet despite these achievements I'd argue that the post Act regulatory regime has yet to deliver its real potential.

Why?

At its most basic, the current regulatory framework is over-engineered.

It is exceptionally complex with ten regulators plus oversight plus a statutory ombudsman scheme.

The regulators operate inconsistent lengthy codes of conduct, and with only six reserved legal activities actually requiring regulation.

Arguably, much of the culture and behaviour of the front-line regulators still rests on detail not outcomes. And understandably perhaps, it still starts from a focus on "*their*" part of the profession rather than seeing matters as a whole.

The continuing link to representative bodies can result in a lack of clarity for the regulators on their objectives and a lack of transparency of the cost of regulation.

There is some evidence that the conservatism of the profession and the caution of its regulators continues to cause difficulties for new provider types to enter the market, especially those with truly innovative delivery models.

The LSB has had to argue powerfully for simple (though proper) process to facilitate the introduction of ABS.

Contrary to comments from the SRA last week we have not been arguing for a "*nod through*" regime.

However in this market detailed regulatory scrutiny of business plans and the existence of rules which cause structural separation or inhibit the models in which professionals can practice should have no place.

Justifying such rules as being in the public interest – without ever offering a definition of what that means, other than "*it's what we do as a public interest regulator*" - just won't wash.

I believe that this primarily stems from two reasons.

Firstly incomplete liberalisation in 2007 and after.

The Act carried over the existing statutory and rule-based frameworks, rather than there being a thorough overhaul.

Because there was no radical change to simplify the existing rule book it feels to many like nothing is being taken away.

Secondly, the institutional framework of regulatory bodies tied to professional organisations.

There is a leftover legacy of over-detailed rules and cultural biases presiding over rigid entry controls, detailed system requirements and regulatory interference in decisions that are better left to commercial entities.

The result is a situation where firms face a common regulatory cost base unrelated to the risk they present.

This in turn leads to unnecessary costs for law firms, but also costs to UK plc through reduced competition, innovation and consumer choice.

The real test is the market one.

It's safe to also say that the current level of regulation does not make services accessible to consumers or build confidence in the legal system as research published by the LSB shows:

- consumers took no action in response to 13 percent of all of the legal problems they faced and handled a further 36 percent themselves without any help, and

- 54 percent of small businesses agreed that "*legal processes are essential for businesses to enforce their rights*", only 12.6 percent agreed that "*lawyers provide a cost effective means to resolve legal issues*", with 45 percent disagreeing.

So it is my view, based on my five years as the oversight regulator that a new framework is needed.

It is needed in order to secure a liberalised market, to offer greater innovation, choice and value to support growth, to improve access to advice and to ease dispute resolution for consumers and business alike.

It is also required proportionately to tackle major risks to both public and consumer interest.

All of these outcomes are equally necessary.

Legal services that offer greater protections for consumers, but which are too expensive for the majority of consumers to afford, would be a poor outcome.

Equally, a regulatory free-for-all or, in my book even more harmful, a return to self regulation by the professions would undermine public confidence and the wider civic role of the law.

That's why the LSB has produced its *blueprint for reforming legal services regulation*.

In it we outline what we mean by a new framework – both incremental, but also significant.

And by that what we mean incremental but significant change to legal regulation in England and Wales.

We propose a short-term action plan to simplify, rather than fundamentally replace, the legislative framework for legal services significantly over the next two to three years if a suitable vehicle can be found.

Better targeted and more proportionate regulation intended to reduce the cost and complexity of regulation.

We also propose an independent review to develop timetabled and costed proposals to develop a new framework of regulation that is structurally, legally and culturally independent of both the professions and Government.

The core model to be tested in this process should be the introduction of 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.

As with other sectors we believe that 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, or in relation to corporate law firms, whose clients are quite often bigger and uglier than the magic circle firms themselves.

Instead, for example, regulation of corporate law firms should be focused on risks to the public interest and on core maintenance of the rule of law.

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 and the performance of advocacy, etc. would be priorities for any regulator.

But more generally, regulation would be directed at entities delivering the service, unless the nature of the risk made individual regulation essential.

This would allow regulation to focus resources on areas of potentially significant detriment to individual consumers and small businesses.

There will also be a need for real focus on legislative and regulatory simplification.

Although many of these changes in our short term action plan would require primary legislation, I don't believe that they would require wholesale revision of the current regulatory framework.

In the short term, 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, and

- fewer restrictions on in-house solicitors acting directly for the public, creating more competition and diversity in the market.

Structural simplification could be achieved by:

- a single 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, removing a maze of separate unconsolidated legislation

- a single approval process for the entry of new regulators and licensing authorities – which I'll say more about shortly

- 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, and

- economies of scale and greater consistency of decision-making through rationalisation of the current sanctions and appeals arrangements.

To steer change in this direction in the short-term, improvements would be 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, and

- 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.

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 feasible in the short-term, it is not too early to begin to think through its core statutory and institutional ingredients.

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 functions.

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

The core 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.

Which of course is a different skill set from that generally found in today's multiplicity of title-based regulators.

Such a body would need to be created from scratch, rather than from the LSB or any of the current approved regulators.

This new regulator should be organisationally, statutorily and culturally fully independent of both government and the 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.

It is disappointing that the call for evidence on the part of some respondents has led to the self-serving arguments about a return to self-regulation by the profession.

In their submissions to the Ministry of Justice review both the Law Society and Bar Council made the case for returning regulation to the professional bodies as a way of cutting the cost of regulation.

This misses the point.

What matters is not who regulates, but how they regulate.

The problem is that self regulation inevitably introduces more regulation not less through, for example, making greater attempts to restrict competition.

This is how it was before the introduction of the Legal Services Act 2007.

And it's hard to imagine why, in all likelihood, it would be different should self-regulation return. Let us remember that the complicated rule books and the significant quantity of poorly targeted and burdensome regulation that the LSB is trying to tackle was put in place before the LSB existed – by the professional bodies.

And since the LSB has been in place, it is the professional bodies that have resisted multi disciplinary partnerships, resisted foreign ownership and private equity, resisted a flexible legal labour market and tried to slow down the pace of change.

We should be very clear that this costs money – higher costs of regulation, higher costs for business and higher costs for consumers.

This unaccountable self-regulation gave us bans on advertising, controls on firm names, restrictions on forms of funding and ownership for firms and other restrictive practices that did little beyond protecting the lawyer from change.

And yet, despite all this intervention by the self-regulators, we still saw significant lawyer involvement in mortgage fraud, scandals such as miners' compensation and systematically poor consumer complaints handling in firms and regulators alike.

Independent regulation has started to challenge this negative legacy of self-regulation by seeking ways to reduce unnecessary regulatory burdens and enable businesses to deliver legal services for people who need them.

Historically the professional bodies now seeking a return to unaccountable self-regulation have designed gold-plated regulation to avoid risk and protect the profession.

The reaction to initiatives such as the SRA's Red Tape Initiative unfortunately suggests that that motivation still exists. And that's why turning back the clock is not an option.

In that context, let me explain a decision we expect to announce later this week, barring some final governance details.

I expect formally to recommend to the Lord Chancellor that the *Institute of Chartered Accountants in England and Wales* (ICAEW) be designated as an approved regulator for probate activities and as a licensing authority for alternative business structures.

The ICAEW's rationale for making the application is to allow its members to be authorised to do probate activities alongside related services (e.g. trust planning and estate administration) that they currently provide.

It will enable firms to offer a more integrated service to clients who, in non-contentious cases, will be able to use a single adviser which in turn should have an impact on the overall cost of the service for consumers and increase competition.

This is a first step for the ICAEW and it is a very considerable step for liberalisation in the legal services market.

I look forward to seeing the ICAEW moving on, in due course, from this beginning to regulating litigation and other legal services as we understand they hope to do.

We have tested the proposals carefully against the criteria in the Legal Services Act and have also taken care to assess that the ICAEW has the capacity and capability to undertake a regulatory role in this sector.

We have also ensured that its governance arrangements are suitably robust in terms of independence.

I hope that the Lord Chancellor will be able to make an early decision followed by a rapid parliamentary progress.

You may ask why, when I've just said that the regulatory architecture is too complex, I'm making it more confusing.

You might also want to ask me the same question, given that I'm on the record as being profoundly sceptical, if not positively hostile, to the concept of regulatory competition in the past.

I take you back to the question of independence again.

The fact is that there are new entrants to the legal market who find a framework derived from years of legal professional regulation too restrictive.

Given the current constitutional position and performance of the regulators, I do believe that the addition of a new player to the scene – even if only for a transitional period before a wholly new body is in place – can only help to speed innovation by all players.

I would only add on this that such a positive development in legal services would not have occurred if the decision had been with the Law Society.

It would not even have reached the drawing board let alone the recommendation stage.

The LSB blueprint is not all that new.

Some of the ideas were canvassed nine years ago by Clementi, others in the course of debate on the Act.

Nine years down the line from his report, six years on from the 2007 Act, we have once more reached a crossroads when it comes to legal services regulation.

As global competition intensifies, and jurisdictions around the world look to offer competitive legal services, it is ever more important that England and Wales keeps up the pace of reform.

The question now of course is what direction will we, the professions, Government and the consumer take.

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.

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.

Changes of structure will take years, and require primary legislation.

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.

I think that the LSB has laid the foundations for that.

But we now need an entirely new building.