Ministry of Justice – Call for evidence on the regulation of legal services in England and Wales

Solicitors Regulation Authority response

September 2013

Introduction

1.1 The Solicitors Regulation Authority (SRA) is the independent regulatory body of the Law Society; an Approved Regulator under the Legal Services Act 2007 (LSA). The SRA regulates solicitors, the firms in which they operate and all those working within those firms. The SRA is also a licensing body for alternative business structures (ABS) and, as such, may regulate entities where no owners or managers are solicitors. The SRA regulates in the public interest.

1.2 We welcome the Ministry of Justice's (MoJ) call for evidence on the regulation of legal services in England and Wales. The call is timely. The current arrangements for the regulation of this sector have their roots in the Office of Fair Trading's (OFT) report, ***Competition in Professions***, which was published in March 2001. This report led to that of Sir David Clementi and legislative change through the Legal Services Act 2007 (LSA). Partly as a result of the changes enabled by the LSA but also as a result of wider social, economic and technological changes, there is now a significant rate of change in the legal services market. These changes are breaking down the historical divisions in the market which linked reserved legal activities to types of individual legal professional defined by the titles they held.

1.3 For the reasons set out in this paper, we consider that the current arrangements implemented following the LSA have resulted in some significant improvements in the regulation of the sector. In addition, existing regulators have yet fully to modernise their regulatory approaches to maximise the benefits that might flow from the LSA. The SRA has made significant reforms to its regulatory approach - these include a radical slimming down of its Code of Conduct, and the reduction and simplification of the historically over-detailed and unnecessarily prescriptive rules, and the introduction of risk based regulation which ensures that resources are most effectively used to address the most significant risks. This programme of reduction and simplification continues so as to maximise the potential of the current arrangements in the public interest.

1.4 However, for the reasons set out in this paper, the SRA's view is that the current regulatory settlement and the legislation that underpins it, remain clumsy, complex, costly and obscure to consumers, and thereby hamper the achievement of the regulatory objectives set out in that Act. They are capable of significant improvement to the benefit of the consumers of legal services and to the providers of legal services. Furthermore, the rate of development of the legal services market and the progressive innovation of providers aimed at delivering more consumer focused and competitive services means that a failure to address the issues raised in this paper will not merely be a missed opportunity for improvement but will increasingly inhibit proper growth and development of services (e.g. as a result of unnecessarily costly or inflexible regulation). Much of the potential reform identified in this paper would require primary legislation which may take a number of years to achieve. Given that, deeper consideration of the issues, options for reform and the development of the future legislative requirements should be started now. Delay in starting to tackle these issues would, as a result of the problems already apparent in the arrangements, run a significant risk of hampering the growth and development of the market, the commercial

development of firms both within England and Wales and as exporters of legal services and, consequently, the interests of consumers of services.

1.5 As the regulator of the greatest proportion of the legal services market, and the regulator of the most diverse range of entities within it, the SRA is in a unique position to provide views on the efficacy of the current arrangements; their strengths and weaknesses. This paper does not advocate a detailed future model and set of underpinning arrangements for legal services regulation, although it does suggest the approach which the SRA considers should be taken in considering reform. Rather, it identifies the issues being experienced and those that, in its view, require prompt attention.

The purpose of legal services regulation

2.1 The relatively early development of the regulation of legal services, through the reservation and “regulation” of titles such as “solicitor” and “barrister”, and the identification of a relatively narrow range or "reserved legal activities", has meant that, historically, the development of legal services regulation has focused on the rules regarding the legal practice of such individuals on a tacit assumption that that was synonymous with regulation of the legal services market. This approach has become increasingly inadequate as legal services have diversified and been delivered through a much wider range of organisations and by a more diverse range of regulated and unregulated individuals. The approach is inconsistent with a modern emphasis upon consumer interest and the promotion of choice and competition.

2.2 This historical perspective was remedied, to some extent, by the Clementi report, which sought to articulate the purposes of legal services regulation in terms of the public and consumer interests. Since then, the presence of the s.1 LSA regulatory objectives has provided a public interest anchor for regulation but, in the SRA’s view, the current legislative architecture for regulation, which continues to rely heavily upon the regulation of titles and narrowly defined reserved activities, is inadequate to deliver modern public interest regulation.

2.3 The starting point for any consideration of the future of legal services regulation has to be clarity about the purpose of that regulation. Whilst the root of this regulation may lie in various arrangements arrived at in previous centuries (reserving activities and titles in a piecemeal way), any modern consideration of the need for regulation must start with the public interest, consumers, competition and market economics. However, where legal services are concerned in particular, the SRA's view is that there are additional factors that must be taken into account.

2.4 These arise where there is a public interest in an outcome being achieved (or harm avoided) which will not be achieved simply as a result of competition operating within the market (i.e. because in any individual transaction between consumer and provider neither necessarily has an economic interest in the achievement of the wider public interest objectives). They are of particular relevance to the legal services market and, indeed, there are a number that are specifically identified in the s.1 LSA regulatory objectives (for example within the professional principles).

2.5 Unlike many other professional services the quality, and professional and ethical standard, of legal services provided do not only directly impact on the consumer of those services. Importantly, legal services and the actions of legal services providers have an impact on:

- public confidence in the rule of law;
- the overall effectiveness of the operation of the legal system;
- the courts; and
- third parties, often but not solely, those involved in a dispute with the direct consumer of the legal services in question.

2.6 The first three of these are important socially, politically and economically. The integrity and independence of lawyers is critical to the functioning of the courts and the administration of justice, and thereby to the protection of the rights of the citizens. For example, the concept of legal privilege requires professionals who are effectively regulated to exacting ethical standards. The importance of an effectively regulated legal system extends beyond the social and political to economic benefits. In "Assessing the economic significance of the professional legal services sector in the European Union", August 2012, Yarrow and Decker's principal conclusion is that "economic analysis and evidence suggests that legal services can have wide ranging economic significance through their very close connection with the general institutional architecture of society (sometimes encompassed by a term such as the 'rule of law'). Moreover, this analysis and evidence suggests that it is not by chance that good economic performance tends to be closely associated with the stable and well- functioning legal systems" and that "(i) the wider contribution of legal services to the effective functioning of the institutions of market economies cannot sensibly be ignored in policy assessments, (ii) that these contributions are important for economic performance, and (iii) the contributions are affected by public policies."

2.7 Given this, we see regulation to protect and promote the interests of consumers (arising for the need to mitigate the impact of information asymmetries) as just ***one*** aspect (albeit a vital one) of the purpose of the regulation of the legal services market in the public interest. The other key aspects are to ensure that the market operates in the wider public interest and to protect the independence of the providers of legal services and quality of those services. This has direct implications for scope and focus of regulatory intervention and for the extent to which competition (alone) can be relied on within this market to ensure the wider public interest is achieved.

2.8 The SRA believes that the argument for effective regulation of this sector is overwhelming, and that the objectives for that regulation, as defined in the s.1 regulatory objectives, are good. Therefore, the issue to be considered is whether, given the above rationale for the regulation of legal services, the current arrangements are those which best enable the delivery of the required regulatory outcomes in a way that meets the well accepted (and statutorily required by s.28 LSA) principles of better regulation. For the reasons set out in this paper, the SRA would argue that they are not.

Current situation – what has worked well and what has not

3.1 It is important to recognise that the LSA enabled major improvements in the regulation of legal services in England and Wales, with beneficial effects on the market, because:

- it provides a clear set of objectives for the regulation of legal services, consistent across the market for regulated services;
- it requires adherence to the principles of better regulation, consistently across all regulators;
- it requires a degree of operational independence of regulation, separate from the representative activities of approved regulators and, given that the regulatory bodies of the approved regulators continue to be part of primarily representative entities, it provides a mechanism, through the Legal Services Board (LSB), to safeguard independence;
- it preserves independence of regulation from Government, and
- it enables the liberalisation of the market - through the ability for non-lawyers to own and manage legal services providers;

3.2 However, the regulatory settlement provided by the LSA remains imperfect. The system functions, and functions better than the pre-2007 arrangements. However, it has significant flaws. For the purposes of this paper the SRA focuses on five major areas where the current arrangements are less than the optimum that might be achieved. These are:

- inflexibility and over-prescription – in a rapidly evolving legal services market, too many requirements are specified to a significant level of detail in primary legislation hampering regulators' ability to meet the regulatory objectives and the principles of better regulation;
- complexity of primary legislation – the SRA has to operate under three major pieces of primary legislation; the Solicitors Act 1974; the Administration of Justice Act 1985 and the LSA. The other approved regulators also work under a multiplicity of legislation.
- inadequate and irrational foundations for regulation – the whole of legal services regulation is founded on the regulation of six "reserved" activities which have accumulated in a piecemeal fashion and have never been the subject of an objective, evidence based, review;
- the multiplicity of regulators – largely based around the historic regulation of titles (albeit in some cases with titles relating to distinct functions – for example licensed conveyancers) – which creates fragmentation of regulation across the legal services market and the need for rules to manage the boundaries of the various regulators. Not only are there eight approved regulators, there is also a layering of regulation with the LSB sitting above all of them. These features add to both complexity and cost.

- regulation is not fully independent – the LSA made regulation more independent from the representative functions of the professions. However, this does not amount to full independence and, for as long as regulatory bodies remain part of strong representative organisations, there will be additional cost and a lack of flexibility within the system. In terms of cost, for as long as the current arrangements remain, the presence of the LSB will be essential in order to ensure compliance with the internal governance arrangements which enable independent regulation, and to deliver some degree of co-ordination between the regulators whose fields of regulation increasingly overlap. In addition the cost burden on the market is also inflated by s.51 LSA, which enables defined but extensive representative activities of approved regulators to be funded through the compulsory levying of practice fees

3.3 These areas are addressed in greater detail in the following sections. However, if one steps back from the current system and takes an overview it has some notable features.

3.4 The whole system of legal services regulation is provider-centric. The key regulatory structures are still built around groups of providers, primarily individuals with titles, who have traditionally operated in the market. The regulatory system is not centred around the overall market which is regulated, the activities within that market or the consumers of services from within the market.

3.5 The legal services market that we are seeking to regulate now and in the future bears no resemblance to that on which the core current foundations are based. In the 19th or 20th centuries a regulatory system based around individual titles undertaking activities reserved only to them may have been workable. Indeed for as long as the individual professions maintained an effective monopoly over niche areas of work, with little cross over between them, such a system could be sustained. However, any examination of the current legal services market will show that the conditions for such a system to continue no longer apply, with legal advice increasingly delivered by non-regulated individuals and non-legal professionals. The rate and extent of change within the market – which is beneficial to consumers and to the economic wellbeing of the country – will make the current system more and more unsustainable.

3.6 Viewed from this perspective, the LSA can be seen as an attempt to bind the fragmented regulatory system together with overarching objectives and an overarching regulator. However, a judgement needs to be made as to whether the benefits of such an approach are now outweighed by the disadvantages (such as cost, inflexibility, lack of clarity for consumers), and whether any alternative regulatory approach would perform better.

3.7 The principles of better regulation are now well established, and strongly supported by the SRA. Their explicit application to legal services regulators is one of the most positive aspects of the LSA. As a part of the further consideration of the fitness of the current system of legal services regulation, there needs to be an analysis of the extent to which the current regulatory ***system*** meets, or is capable of meeting, those principles.

Areas for further examination - inflexibility and over-prescription

4.1 In the SRA's view the preconditions for an effective system of regulation are:

- a clear definition of the scope of the activities to be, or capable of being, regulated;
- a mechanism to establish, maintain and hold to account an independent regulator – that is, independent from those subject to regulation and independent from the government and executive;
- the provision of the necessary statutory powers;
- clear regulatory objectives for the regulator; and
- a requirement to meet the better regulation principles and regulatory best practice.

4.2 Past this point, caution is required before further detailed requirements are included in primary legislation. The market for legal services is evolving rapidly and the risks that the regulator must address to deliver the outcomes that flow from the regulatory objectives will change over time. Excessively detailed requirements set out in primary legislation run a significant risk of unnecessarily and inappropriately fettering the regulator's ability to meet the regulatory objectives in accordance with better regulation principles and best regulatory practice.

4.3 In fact, these are the conditions under which approved regulators are operating within the current regulatory framework. This damages the regulators' ability to regulate effectively in the public interest and increases cost and bureaucracy because they have to do things because they are ***required*** by the primary legislation and not because they are necessary when measured against the regulatory objectives and the better regulation principles.

4.4 A good example of inflexibility and over-prescription is s.91 (1) (b) of the LSA which requires the Head of Legal Practice of an ABS to report to the regulator, "any failure to comply with the terms of the licence". It is necessarily a requirement on any regulated body to comply with the regulator's regulatory arrangements. Given this, s.91 (1) (b) requires an ABS to report every breach of the regulatory arrangements to the SRA – no matter how minor. This is a disproportionate requirement and one which the SRA would not impose. Yet it has to because of the statutory requirement.

4.5 Similarly, Schedule 13 to the LSA deals with the approval by the relevant licensing authority of the holding by a non-authorised person of a restricted interest in a licensed body. The provisions concerning who is subject to such approval are extremely complex and prescriptive. The SRA has now had experience of licensing 169 bodies and the complexity of Schedule 13 has been one of the factors that have led to the licensing process taking time to complete. We believe that it is important to be able to require the approval of individuals throughout the ownership structure of a licensable body but it is

the mandatory nature of Schedule 13 that sometimes causes difficulties and does not allow the SRA to take a risk based approach to regulation.

4.6 These issues could be addressed by amending Schedule 13 to allow licensing authorities to exercise discretion in the approval process. This would enable a licensing authority to consider whether it is proportionate from a risk based perspective to approve all persons throughout the ownership structure.

4.7 Another example is provided by s.9 Administration of Justice Act 1985 (AJA) as amended by the LSA. The amended AJA is the basis for entity regulation by the SRA. Whilst the regulation of individuals plays, and will continue to play, an important role in legal services regulation, the primary regulatory mechanism is now on the entities providing legal services. Section 9 is highly prescriptive about the form of the legal structures that may be utilised and the approval of those structures. This is already causing difficulties in the authorisation and regulation of English and Welsh law firms either merging with or entering into alliances and groups with overseas law firms. In addition, without changes to primary legislation the SRA are unable to entity regulate traditionally structured law firms with a sole solicitor principal. Such firms can be of significant size with many employees, including other solicitors. However, at present they cannot be regulated as entities but only as “sole practitioners” through an endorsement on the sole principal’s practising certificate. In order to enable the SRA, as far as possible, to use a common regulatory approach, the key entity based regulatory requirements are duplicated in the regulatory Handbook so as to apply to sole principals in their practice. However, such an approach necessarily increase the volume of regulatory arrangements, their complexity and resources needed to maintain them.

4.8 These are simply a small number of examples to illustrate the difficulties caused by the over-prescription of regulatory requirements in primary legislation. They are a direct driver of cost, a barrier to better regulation and tend to be a barrier to development and innovation by law firms.

4.9 Addressing these issues could be a first step to enable regulators to improve the regulation of legal services in England and Wales as they would enable each of the Approved Regulators to follow the principles of better regulation more closely. They could be made (albeit requiring changes in primary legislation) without changing more fundamental (and possibly more controversial) aspects of the current regulatory arrangements. These issues must be addressed in any replacement of the existing legislation with a new Act. If the outcome of the Ministry’s review is not to be a fundamental review of the regulatory approach and significant statutory change, there would still be significant benefit in reviewing the current statutory provisions and stripping out unnecessary prescription.

Areas for further examination - complexity of primary legislation

5.1 The SRA now operates under an extremely complex statutory framework as the majority of our regulatory powers are derived from several statutes: the

Legal Services Act 2007, the Solicitors Act 1974, the Administration of Justice Act 1985 and the Courts and Legal Services Act 1990. In addition to these Acts, some additional powers in relation to licensed bodies are also found in the Legal Services Act 2007 (The Law Society and the Council for Licensed Conveyancers) (Modification of Functions) Order 2011. This complex statutory framework creates difficulties for those we regulate to understand our statutory authority for certain powers and also causes problems with consistency as our powers sometimes vary according to the particular individual or entity that we are regulating.

5.2 There are inconsistencies in the legislation, for example the SRA has different statutory powers in respect of traditional law firms and ABS.

5.3 With the exception of the LSA, the other approved regulators operate under different legislative provisions, again with differing powers. There are two aspects to this:

- first, the SRA itself is faced with regulating recognised and licensed bodies with different sets of statutory powers; and
- second, the approved regulators, regulating within a single market and increasingly the same or overlapping services, do so with different statutory powers.

5.4 In relation to the first of these issues, there are numerous areas of difference faced by the SRA. For example, in respect of:

- compensation arrangements;
- fee charging powers; and
- disciplinary and fining powers.

Further information on these specific issues is set out at Annex A; although it must be emphasised that they are simply examples from amongst a wider range.

5.5 The SRA advocates a single statutory framework for entity regulation in the legal services market with a common set of statutory regulatory powers and without specific statutory obligations on regulators to treat particular types of regulated entity differently from any others. This does not mean that all regulated entities will be subject to the same regulatory processes or controls. However, where these do differ they should differ as a result of a transparent and proportionate response to the different risks posed to the regulatory objectives posed by, for example, different business or ownership structures. The SRA's view, from its experience of ABS licensing and supervision to date, is that the regulation of ABS does not require a separate statutory scheme.

5.6 In relation to the second bullet point at paragraph 5.3 above, the issue is that, viewed from a public interest or consumer perspective (rather than a provider or regulator perspective) the regulation of entities delivering the same types of legal service to the same consumer population to different rules and

standards, seems to make little sense. Why should, for example, protections or remedies attaching to the same service (e.g. conveyancing) differ for a client depending on the statutory basis for the regulator of the service provider selected?

5.7 This patchwork of legislation and inconsistency (both applying to individual regulators and as between different regulators) adds complexity, obscures transparency of regulation and adds cost to the system. In the SRA's view it is well overdue rationalisation into a single piece of consolidated legislation. Should this be undertaken then it would also be an opportune time to address the issue of over-prescription and inflexibility identified in section 4 of this paper.

Areas for further examination - inadequate and irrational foundations for regulation

6.1 The LSA left the pre-existing reserved legal activities in place as the basis for legal services regulation. In some ways this was an understandable decision. The LSA was a major change in the regulation of legal services and, following as it did from the OFT and Clementi reports, the strong focus of the public and political debate was competition, the economic liberalisation of the delivery of legal services and the changes to the structures for regulation felt to be necessary for that liberalisation to be carried through. Within this context there was, reviewing the debates with hindsight, a sense that a concurrent review and reform of the underpinning foundation of legal services regulation (i.e. the reserved activities) simply lay in the "too difficult" box. There is also a sense that it was considered that, in practice, they could continue to serve as the basis for the effective and broad regulation of legal services for two reasons:

- first, because there had been little evidence of commercial legal service providers seeking to provide only non-reserved activities outside of the scope of the existing regulators' grip; and

- second, because the long-existing approach to legal services regulation in England and Wales, primarily regulation "by title", had ensured that the very wide range of non-reserved legal activities being provided to consumers was regulated because all of the activities delivered by, for example, solicitors were kept within the regulatory grip of the relevant regulator.

6.2 In practice, neither of these two assumptions has proved to be correct. First, because there has been a significant growth in the commercial provision of non-reserved legal activities by unregulated providers. For example, Employment Tribunal statistics show that from 2009/10 to 2011/12 the proportion of claimants represented by lawyers fell from 69% to 46%, by Trade Unions from 5% to 3% whilst representation by other types of organisation/individual rose from 7% to 30%. Second, because the mechanisms used by existing regulators to maintain their wide grip on all legal activities (such as the SRA's separate business rule) are being challenged by the LSB as being inconsistent with competition and with the will

of Parliament (i.e. Parliament's decision that only the reserved activities required regulation).

6.3 The decisions made by Parliament not to review the reserved activities can be viewed in two ways. One view is that it was a completely correct political judgment to ensure the delivery of the critically necessary changes by ruthlessly excluding from consideration a complex issue that would have distracted attention and may have endangered the successful implementation of those key changes. The alternative view is that it was a significantly missed opportunity to undertake the necessary complete, radical and once in a generation overhaul that was necessary.

6.4 Regardless of the rationale for the decisions made in 2007 and earlier, they have, in our view, resulted in a significantly unsatisfactory system of regulation. The result is what has been described as a "patchwork quilt" of legal services regulation which does not necessarily serve the citizen's interest in the wider aspect of the rule of law (how it operates in the public interest and how quality legal services are delivered to a high ethical and professional standard) and, specifically as an aspect of this, how the interests consumers are protected.

6.5 In our view this detriment arises because of:

- a lack of clarity for consumers about which legal services are regulated and which are not against an underlying consumer expectation that all professional legal services will, in one way or another, be regulated (as evidenced, for example, in the University of Leicester's report for the Legal Ombudsman (2011) and the SRA's 2011 research, ***Consumer attitudes to the purchase of legal services***);

- a lack of consistent consumer protection and redress not only between regulated and unregulated legal services but also between services regulated by different regulators;

- a lack of focus on quality, standards and ethical behaviour across all legal services leading to the risk of a failure to get things right first time for consumers and, therefore, an unnecessarily heavy reliance on redress;

6.6 As a result the SRA's view is that, particularly with the experience that the SRA and others have had in implementing the LSA changes, it is now clear that the time has come to complete the reform process.

6.7 In order to address all of the issues the SRA advocates a move to defining all legal activities as being within the scope of regulation. To achieve this it would first be necessary to define "legal activity". This might be possible by taking the approach adopted in the Financial Services and Markets Act 2000 where, in Schedule 2, a very long list of specific financial services activities is identified. Essentially this would involve adding specific activities to the reserved legal activities currently set out in s.12(1) and Schedule 2 LSA. Alternatively, and in our view a better approach would be to encompass the currently reserved legal activities as well as legal activity as defined in section 12(3)(b) of the LSA:

"(b) any other activity which consists of one or both of the following -

(i) the provision of legal advice or assistance in connection with the application of the law or with any form of resolution of legal disputes;

(ii) the provision of representation in connection with any matter concerning the application of the law or any form of resolution of legal disputes."

6.8 In principle, this would bring within the scope of regulation, and therefore consumer protection, the entire range of currently unregulated legal services - e.g. the provision of employment advice by non-regulated employment service providers and will-writing service providers.

6.9 To achieve proportionality in accordance with the requirements of the Government's principles on better regulation such an approach could include provisions for exemptions/exclusions, for example, in the following types of circumstance:

- where another competent regulator which meets the necessary standards for independence, training, supervision and enforcement exists. An example would be where an accountant provides tax advice which fell within the definition of legal activity that must be regulated. This activity is regulated, now, by the Institute of Chartered Accountants in England and Wales and the legal advice would either be encompassed within their regulation or, under a specific exemption (for example in the same way as solicitors are currently able to provide financial advice under the Part XX exemption provisions under FiSMA;

- where the provider is a practising member of a foreign regulated legal profession and the advice relates to the application of that jurisdictions' law; or

- where the activity is a necessary but subsidiary part of a main service which is not itself a legal activity that must be regulated. An example would be incidental advice on an employment contract provided by a recruitment agency to a job-seeker.

6.10 The regulation of all such activities would have to be undertaken within the objectives currently provided by the combination of ss.1 and 28 LSA which require regulators to take account of issues such as targeting and proportionality. The arrangements applied to any particular category of activity should therefore be capable of being those necessary to address the relevant market failures without being disproportionate, reducing competition or increasing cost and barriers to entry.

6.11 A necessary part of this approach would be to ensure that the regulator, or regulators, was capable of deploying the full range of possible regulatory interventions appropriately (for example, making greater use of the provision of information direct to consumers which is a regulatory toll which has generally been under utilised by existing regulators). It should not be assumed that within this new approach regulators should continue to regulate in the way that they have historically done.

6.12 At one level this might appear to lead, necessarily, to increased levels of regulation and cost. However, in the SRA's view this would not be the case if such a system were introduced as part of range of reforms which reduced the overall complexity and costs of the system. The broad definition of the activities within the scope of regulation would, of course be subject to the regulatory objectives, better regulation principles and regulatory best practice. The proper application of risk-based regulation by the regulators within this broader framework would, in the SRA's view, enable more proportionate and targeted interventions and, therefore, a reduction in the overall regulatory burden. In doing this, regulators should take account of the much greater levels of general statutory consumer protection afforded to all purchasers of goods and services. These protections are significantly greater than when many of the current legal services regulatory protections were first introduced. The regulators would be able to do this without the artificial proxies that are currently used as a result of the narrow scope of the reserved activities. Most importantly it would enable a move away from a reliance on regulation by title and by the structures permitted for regulated entities. In the SRA's view it is the key condition precedent to enable better regulation of the legal services market in the public interest and also relevant to addressing the issues identified in sections 6 and 7 of this paper.

Areas for further examination - the multiplicity of regulators

7.1 In paragraph 3.4 we described the current system of regulation as "provider-centric". This is mirrored in the fact that the market currently has eight approved regulators with others seeking to become approved and existing regulators seeking to extend the scope of their regulation.

7.2 Whilst it is understandable that organisations may wish to expand their range of activities (particularly where it enables those they regulate to expand their range of business), viewed from the perspective of the desirability of a simple, coherent and transparent system of market regulation, it is in the SRA's view undesirable.

7.3 Viewed from the perspective of the consumer it is confusing and difficult to understand. Consumers have differing levels of protection and redress depending on the regulator of the provider that they seek to purchase their service from. At paragraphs 5.3 and 5.6 above, we have referred to the impact on consumers of regulators applying differing regulatory standards and protections to services which, from a consumer perspective, are the same. Some of these differences flow from the differing statutory bases for the individual regulators. However, others flow simply from different choices made by the various regulators, for example, the conflict of interest rules applying to conveyancing transactions or the levels of indemnity insurance and compensation protections applicable to those transactions. It is not apparent that a system of legal services regulation with a greater emphasis on the needs of consumers would permit these differences.

7.4 In addition, such a system is necessarily more complex and costly to operate. Rules are required to manage the interfaces between different regulators and it is the multiplicity of regulators (including the need to consider applications

for approval or extensions of regulatory remit) which provides one of the reasons for the existence of the LSB (with the additional systems costs that flow from that).

7.5 Given the current market for legal services and its future development, regulation based around individual types of provider, with all of the consequences that flow from that, appears to be increasingly unsustainable. It is, and will growingly be, an unnecessary factor for businesses to consider as they evolve and seek to expand and develop their own structures and services to consumers.

7.6 The problems associated with this issue have become more acute with the increasing focus on entity regulation. When legal services regulators primarily focused on the regulation of individuals and titles the issue of regulatory overlap was to a large extent theoretical rather than practically problematic. However, within mainstream consumer legal services, it now seems probable that the current main entity regulators (the SRA and Council for Licensed Conveyancers) will be joined by The Bar Standards Board, ILEX Professional Services and the Institute for Chartered Accountants in England and Wales. Although the scope of the reserved legal activities regulated by each of these regulators may initially be narrow, it is inevitable that they will progressively increase to create greater areas of overlap. This is not a criticism of any individual regulator or an argument for the SRA to have, in some form, exclusive rights of regulation. Rather it is an issue that needs to be considered in the wider context of the public and consumer interest in a system of legal services regulation that is fit for purpose. It does not appear to be in the public interest, or in the interests of consumers, that the same regulated legal service might be delivered under one of, say, five different regulatory standards.

7.7 This issue is also related to that which is considered in section 8 of this paper regarding regulatory independence.

Areas for further examination - regulation is not fully independent

8.1 As has been acknowledged, one of the benefits of the LSA 2007 was the requirement for regulation to be “independent” of the representative functions of the existing professional bodies (i.e. the approved regulators under the LSA 2007). However, it is important that there is clarity about the extent of this “independence”. We do not have independent regulation of legal services in England and Wales in the sense that many of the other well established professions do.

8.2 This arrangement flowed from Clementi’s recommendations where the options for achieving regulatory independence were considered.

8.3 Clementi recognised the need for legal services regulators to be independent; that is independent of both government and independent from those subject to regulation. His recommendation, given effect in the LSA 2007, was for operational rather than structural independence. Under these definitions “structural” independence implies no formal ties between a regulator and

other bodies, and “operational” independence implies that there are formal ties, such that processes are required to allow the regulator to act in an independent manner.

8.4 We take it as a given that the need for independent regulation is accepted. There is a range of evidence setting out the benefits of regulatory independence through delivering decisions made in the public interest rather than in the interests of the regulated community. This primarily focuses on the benefits of regulators being free from outside influence and of decisions being made in the interests (both short and long term) of those being regulated rather than in the public interest. For example, in terms of making long term investment decisions which are likely to be more effective without the pressure of outside influence focusing on short term issues such as the immediate cost of regulation.

8.5 We consider it unlikely that the Government would seriously countenance a return to the pre-LSA position or that any serious commentator or professional body would advance such an argument - to do so would fly in the face of both well established public policy and the evidence of the problems which the pre-LSA position created. Given this, we have not included material to demonstrate the well established benefits of independent regulation or the practical evidence and experience we have to demonstrate that it would not be in the public interest to return regulatory responsibility to the representative organisations of those being regulated. However, we would be happy to provide further material on this issue if required.

8.6 The issue for consideration therefore is whether the compromise position, proposed by Clementi and adopted by the LSA 2007, of operational rather than structural independence is the optimum arrangement for regulation for the future.

8.7 It is important to note that the statutory provisions regarding operational independence in the LSA (s.30) are not, in themselves, particularly strong. The professional bodies remain the Approved Regulators and, from the SRA’s direct experience, are still capable, within the statutory framework, of exercising, or attempting to exercise, a degree of influence over “independent” regulators. For example, the application for the SRA to become a licensing authority for ABS (a key step in the programme to liberalise the legal services market) required the approval of the Law Society Council. This was obtained but the process consumed a very significant amount of time and energy and there was considerable pressure to adopt an approach to licensing which, in the view of the SRA Board, was unjustified on purely regulatory grounds.

8.8 There are good reasons to believe, both in terms general regulatory experience and in terms of the specific position of legal services regulation, that structural independence would yield greater benefits than operational independence. This is because overall regulatory costs will be lower under structural independence, as certain structures and activities needed to ensure operational independence can be avoided.

8.9 So for example, for as long as the current arrangements exist, there will, in the SRA’s view, be an absolute requirement for the presence of the LSB in order to ensure that operational independence is maintained in each of the

approved regulators. The SRA's experience has been that the delegation of operational independence from the Law Society has been given grudgingly and constant vigilance is required, backed up by the prospect of intervention by the LSB, in order to ensure that the SRA is able to operate independently as required by the LSA 2007.

8.10 In addition, the current structures for operational independence require complex and expensive governance arrangements that consume time and management attention and add delay into regulatory decisions. At its simplest level, the SRA Board is subject to oversight by a Law Society "Business and Oversight Board", the Law Society Council and the LSB. These governance arrangements are costly.

8.11 In addition, it is, on one analysis, proper to consider the costs incurred by representative bodies using the "permitted purpose" provisions of the LSA 2007 as a cost to the regulated market (and hence the consumers of legal services") as a cost of the "operational independence" model. The entities regulated by the SRA since the introduction of ABS are evolving rapidly and we are now licensing many commercial entities (accountancy firms, insurance companies, major high street consumer brands) that would not consider themselves as solicitors firms and having little association with the Law Society and its activities undertaken on behalf of solicitors. Nevertheless they are required, as a condition of practice, to pay fees to fund the Society's activities. In the SRA's view this compulsory levy is now, and will increasingly become, unsustainable: not just for new business models but for all of those regulated.

8.12 To illustrate the magnitude of the costs involved and burden on the sector arising from the current settlement, in 2014 the SRA will require £53.7m in practising fees from individuals and entities for regulation; in addition we will charge £31.8m (plus a further £10m for reserves) for the Law Society's permitted purposes – this is in addition to the fees that must be levied to fund the LSB, the Legal Ombudsman, and the Solicitors Disciplinary Tribunal. When there is a real pressure to reduce regulatory costs across all types of regulation, can compulsory levies of this magnitude continue to be justified (in addition to the other additional costs of operational rather than structural independence) when there might be a more effective alternative?

8.13 When this issue was considered by Clementi it seems that there were two main reasons for the selection of this model over full structural independence (it was, for obvious reasons, the model preferred by the existing professional bodies):

- concerns were expressed about how structural independence could be established free from government influence (which is accepted as an essential criterion given the need to ensure the independence of the legal professions from the executive –actual and perceived); and

- Clementi felt that the operational independence model would best maintain the commitment of the professions to good regulation.

8.14 In respect of Clementi's second concern (professional commitment) it has been the experience that this has been more of a theoretical benefit than a

practical one and therefore little or nothing would be lost by the move to full structural independence from operational independence. This does not mean that individual professionals and individual firms are not supportive of high professional standards or of good regulation in the public interest; nor that regulated professionals should not play a major part in the work of the regulator (as they do through membership of the SRA Board, its committees, and through extensive networks of consultation). Rather, it is the case that little or nothing is added to this commitment by placing the regulatory body within a body that sees its purpose, and is seen by many of its members, as overwhelmingly representative in nature. In addition there is, to put it at its lowest, scope for confusion in the eyes of the public and consumers as to the independence of the SRA given that it is legally and structurally a part of the Law Society.

8.15 In relation to the first point, it would be possible to put in place a regulatory entity that was both independent of government and independent of the profession. For example, possible models of independent press regulation, developed post the Leveson report, produced technically viable options. In our view a model involving an independent appointments panel for an independent regulator, accountable to Parliament, could be developed. In doing so it would, of course be essential to demonstrate that the new system was, both in theory and in practice, undeniably independent from government and the executive and that the regulator would have an appropriate understanding of both legal services markets and the values that lawyers protect. However, the key issue might well be whether, given the powerful interests that might favour the status quo, such a model could be delivered (again providing analogies with the post-Leveson debate on press regulation).

8.16 In considering the options that might be available, the SRA believes a number of additional factors should be noted.

8.17 Should a structurally independent model be developed, the existing arrangements for the LSB would not be appropriate. For example, the Chairman and members of the Board are directly appointed by the Lord Chancellor. A structurally independent frontline legal services regulator could not have such a close accountability to a member of the executive. Therefore, the SRA's view that consideration should be given to the benefits and disbenefits of a structurally independent legal services regulator should not be read as advocating that the LSB as currently constituted assume that role.

8.18 In addition, although we refer to an independent regulator we believe that all options should be considered as to whether there should be a single frontline regulator or a number of regulators. The issues arising from either model would be different.

8.19 Finally, the issue of structurally independent regulation needs to be considered in the context of the legal services sector, and how it is likely to develop over the next ten to twenty years, and the issues raised earlier in this paper; particularly in regard to the purpose of regulation, its scope and the current multiple regulator model. In doing so we would argue for a broad consideration of the issues and options.

8.20 For example, there is not a simple choice to consider between the current model and ones where the current regulatory responsibilities of the eight

approved regulators are simply moved to eight structurally independent regulators or a single independent regulator. For example, in section 7 we referred to a particular concern about the multiplicity of ***entity*** regulators as opposed to title regulators and the potential this has to cause a lack of clarity for consumers and the requirement to manage multiple regulatory overlaps for providers. Given this, one model that might be considered would be for there to be a single regulator for legal services and legal entities, but with the professional bodies assuming certain responsibilities for the award of titles. It is possible that the strongest argument for a move to structurally independent regulation will be the need to remove the complexity and risks to consumers arising from the multiplicity of entity regulators within a single legal services market.

8.21 For the above reasons the SRA believes that a full analysis of the options for structural independence of legal services regulation needs to be undertaken by MoJ as a result of this call for evidence with a full impact analysis both of the financial and other benefits and disbenefits. In undertaking this analysis it will be important to start from the purpose of public interest legal services regulation, an appreciation of the current and future direction of the market, the needs of consumers within that market, the wider public interest, and the principles of better regulation.

Conclusions

9.1 In the SRA's view, the case for further analysis and work on all five of the areas covered above is overwhelming. The legal services sector is important to the England and Wales, not just to individual citizens and consumers but also to the economy. There is scope for significant improvement in the current arrangements. At present we would consider these to be significantly desirable but, given the pace and degree of innovation and development within the sector they will very quickly become essential if the system of regulation is not, itself, to become detrimental to consumer interests and sector development.

9.2 It is, unfortunately, the case that the changes required necessitate primary legislation and it is recognised that government and Parliamentary time to effect such changes is limited and only areas of real priority can expect the application of such resources. Nevertheless, we consider that the potential benefits flowing from changes in the areas set out above have the potential to be significant and therefore justify the application of those limited resources.

9.3 There is little doubt that remedying the issues identified in sections four and five of the paper, although still requiring legislation, would be less contentious and therefore easier to deliver than the issues identified in sections six, seven and eight. They would however, still provide significant improvements in the regulation of legal services and, therefore be worthwhile in their own right.

9.4 The SRA very much welcomes this initiative by the Ministry and is keen to continue to be involved in the development of ideas to improve the current system of regulation.

Annex A

Complexity of current legislation – further detail

1 Section 5 of this paper refers to the problems arising from the complexity of the statutory framework within which the SRA operates. This annex provides more detailed information to support the specific examples provided in section five. It should be noted that these are simply examples and not a comprehensive list of all the issues; of which there are many.

2 Examples of the differing nature of the statutory powers provided to the SRA include the provisions in the LSA concerning compensation arrangements do not provide sufficient powers to enable the SRA to operate a compensation fund scheme which provides the same protection to clients of licensed bodies as it does for clients of solicitors and recognised bodies. The Solicitors Act 1974 (SA) expressly permits the Society to make rules requiring contributions to the fund. It also sets out certain powers in relation to the maintenance and administration of the fund. These include the power to:

(a) recover contributions as a debt;

(b) invest money held in the fund;

(c) insure the fund;

(d) borrow for the purpose of the fund in accordance with its rules; and

(e) charge any fund investments as security for such borrowing in accordance with its rules.

3 Section 83(5) (d) of the LSA provides that licensing rules of a licensing authority must contain “appropriate compensation arrangements”. Paragraph 19 of Schedule 11 to the LSA then clarifies that these rules may authorise the licensing authority to:

(a) establish and maintain a fund or funds;

(b) take out and maintain insurance with authorised insurers;

(c) require licensed bodies or licensed bodies of any specific description to take out and maintain insurance with authorised insurers

4 In order to address the differences between the statutory powers available under the SA and the LSA in relation to compensation arrangements, it was necessary for an Order to be made under section 69 of the LSA which modified various provisions in the Solicitors Act 1974 (SA) to apply them to licensed bodies and to allow the compensation fund to be operated as a single fund. The original section 69 Order – The Legal Services Act 2007 (The Law Society and the Council for Licensed Conveyancers) (Modification of Functions) Order 2011 – modified the SA to enable the Society to make rules so that the compensation arrangements would extend to licensed bodies during a transitional period which was due to end on 31 December 2011. This Order was subsequently amended to remove references to the

transitional period. This Order would not have been necessary if the appropriate powers were contained in the LSA.

5 Another example is that the fee charging powers in Schedule 11 to the LSA have also caused difficulties because of inconsistencies with the fee charging powers in the Administration of Justice Act 1985 (AJA). Schedule 11 to the LSA does not make provision for the SRA to charge for the approval of certain role holders in a licensed body. This means that whilst the costs of the approval process can be incorporated into the initial application fee to become a licensed body, there does not appear to be any provision to enable the SRA to charge for approvals that may be required after the licence has been issued, for example, where there is a change in an authorised role holder such as a HOLP or HOFA. The position is different under the AJA as section 9(2)(aa) of the AJA allows the SRA to charge a fee for other applications that are made under the rules that apply to recognised bodies. This inconsistency causes difficulties when trying to develop processes that are appropriate for both recognised bodies and licensed bodies.

6 As well as introducing a new type of law firm, the Legal Service Act introduced a separate disciplinary regime for such law firms. Broadly speaking the majority of disciplinary decisions in respect of 'traditional' firms and those working within them are made by the Solicitors Disciplinary Tribunal ('SDT'). In contrast, disciplinary decisions in respect of Alternative Business Structures are made by the SRA and instead can be appealed to the SDT.

7 Our view is that two very distinct disciplinary regimes for potentially very similar misconduct and very similar firms is undesirable and carries unnecessary complexity. For example, a solicitor working in an ABS found to have been involved in very serious misconduct may be disqualified from working in ABSs under the Legal Services Act by the SRA. However, the evidence would need to be tested again and a further decision made at the SDT (such as to strike the individual from the roll of solicitors) in order to prevent the individual from carrying on some other types of legal practice as a solicitor. There is therefore a significant risk of duplication in time and cost. There is also a risk of significant concern among stakeholders in respect of what might be felt to be inconsistent outcomes between the two regimes.

8 Since obtaining significantly increased disciplinary powers in respect of ABSs (including power to levy a fine of up to £250m) the SRA has reviewed its disciplinary and adjudication processes to prepare for the use of those new powers. It is perhaps difficult to reconcile the fact that the SRA is now operating a statute based disciplinary regime for one type of law firm involving significant penalties and removing individuals from practice (with appeal to the SDT) alongside the 'traditional' regime where most decisions made are subject to a considerably more time consuming and costly process at the SDT (because SRA fining powers for solicitors and traditional law firms are limited to an inadequate £2,000). Currently, for example, if the SRA levies a fine in respect of a regulated person under the 'ABS regime' the matter is expected to be resolved on average 10 months quicker and with the regulated person paying legal costs which are cheaper by a sum in the region of £8,000 than if the matter involved a 'traditional' firm. In 2012 94 fines were imposed by the SDT in respect of 'traditional' firms or those involved in them. The mean

average costs order imposed at the SDT in 2012 for fines of £3,000 was £6,994.50 (the median was a similar sum). The costs incurred by the regulator in disciplinary matters are mostly paid for by the legal services market as a whole in practising fees and ultimately by the consumer paying for legal services.

9 While some stakeholders may favour a completely separate and independent first instance decision maker such as the SDT in all cases, the ABS model for disciplinary action does permit an appeal to the SDT of the SRA adjudicator's decision for those who wish to challenge the decision.

10 In order to improve proportionality, increase consistency and fairness and reduce the expense and time incurred by all involved in the disciplinary process, the SRA has previously proposed to the MoJ and other key stakeholders that there should be a significant increase in the SRA's powers to impose fines under the 'traditional' regime (with appeal to the SDT as in the ABS regime). In effect, this would mean extending the approach in the ABS regime to some disciplinary action in respect of 'traditional' firms and those involved in them. The MoJ have indicated that primary legislative change would be required to achieve this but that a more modest increase may be feasible without this. We remain of the view however that applying the ABS disciplinary regime more widely would significantly simplify the regulatory regime and bring direct benefits for those involved in the disciplinary process as well as improving the efficiency of the process more broadly. Legislative changes to increase the SRA's powers to impose fines would be relatively simple in our view to achieve and would bring significant benefit, in particular in terms of the cost of regulation.

11 Consideration could also be given to adopting the approach to disciplinary action in the ABS regime more widely (i.e. beyond fining powers), such as by the regulators agreeing all disciplinary sanctions (including strike offs and suspensions from practice) with a regulated person in appropriate cases. Agreeing disciplinary outcomes with regulated persons have already proved to be successful in achieving proportionate outcomes which protect the public interest and minimise costs and waiting time for tribunal hearings; their use could be extended to cases involving more serious misconduct.