Legal Regulation Review

An Independent Review of the Regulation of Law Firms by the Rt Hon Lord Hunt of Wirral MBE

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Initial Response to Evidence

May 2009

Foreword

1. We are probably all a bit punch-drunk by now as one piece of economic bad news follows another, and sadly no one can be wholly immune from the effects of the current recession. Looking forward, however, I do believe solicitors, as both a profession and an industry, can continue to be rightly admired at home and abroad, but only so long as we demonstrate leadership and vision, and unite around a positive agenda.

2. My brief from the Law Society is to produce an independent report into the future regulation of law firms. The terms of reference are these:

   'In light of current and forthcoming changes in the Legal Services market, the differing needs of different types of client, current regulatory debates and the need to promote equality and diversity, to consider the appropriate regulatory rules, monitoring and enforcement regime to ensure high standards of integrity and professionalism for solicitors and their firms in all sectors, and to make recommendations.'

3. In January I inaugurated a three-month consultation period and this document is intended to encapsulate my interim thoughts at the mid-way stage of this very important undertaking. Nothing is written in stone and between the time of writing (April 2009) and the signing-off of my final report, which I expect will take place in the summer of 2009, I remain open to persuasion on all or any of the points that follow. Nonetheless, I hope my general direction of travel will be discerned and, by default, I would expect to continue on much the same lines in the weeks and months ahead.

4. I am delighted to report I have been inundated with responses, some of which have provided me with fresh and helpful insights into the future regulation of law firms. I must add, however, that I was disappointed by the fact that some of the submissions I received proved to be rather lacking in breadth of vision, and in the ability to see beyond the sectional interests of those who sent them. My remit is principally to produce recommendations about the substance of regulation, but in my view this cannot be totally divorced from questions about the nature of the regulatory regime itself.

5. It is entirely in the public interest that we should do everything we can to build a modern and successful legal profession here in England and Wales, as a beacon of integrity, embodying the highest possible standards in all we do. That requires an appropriate regulatory regime, setting out clear requirements for practitioners, in line with the principles of good regulation, and enforcing them in a proportionate and reasonably empathetic fashion. In an ideal world I would be able to breeze through the question of the regime in a single, upbeat paragraph, but at the time of writing I do not yet feel able to do that, for certain questions remain open, and tensions unresolved. Nothing, however, would make me happier than feeling confident enough to ignore structural matters entirely when I come to draft my final report in a few months' time. Great opportunities and also serious dangers lie ahead for us and we should not dissipate our energies in *omphaloskepsis.* We must resolve these matters swiftly, then move on to discuss questions of greater substance and import.

6. For the record, I remain convinced that the model for statutory, profession-led regulation proposed by Sir David Clementi and then enshrined in the Legal Services Act 2007 is the right model and can, will and <u>must</u> be made to work, in the interests both of the profession itself and also of consumers – in other words, in the <u>public</u> interest. We must endeavour to ensure it works, in accordance with the regulatory objectives clearly set out in the Act, lest we find ourselves on a slippery slope towards direct, statutory regulation.

7. I believe relatively minor adjustments to the internal governance of the Law Society could be of enormous benefit to the regulation of law firms and I may enlarge upon that thought in my final Report, depending of course upon the progress of the Legal Services Board's consultation on this question. I also believe that a regulator is entitled to – and indeed should – take a close interest in the internal governance of the entities it regulates. Indeed, if any single, dominant theme has emerged during our work, it has been that of <u>sound governance</u>. This will be apparent in this Initial Response and also, I believe, in my final Report. The more effective the governance, the lower the risk – and the less intrusive and prescriptive the regulation required.

8. I have been a solicitor since 1968 and I have always believed it to be a privilege to belong to a profession characterised by its integrity and its commitment to justice and the rule of law. If we can successfully lay the foundations by getting the structure for regulation right, and then also ensure that the substance of regulation is proportionate and effective, perhaps even in this rather cynical age we can reaffirm our reputation as, if not the oldest profession, then at least the proudest and most respected profession.

9. In closing, let me reiterate: this is only an Initial Response to Evidence and, between now and the end of June, I still hope to hear from many more of you, with your ideas, experiences and suggestions – and your responses to this document.

Rt Hon Lord Hunt of Wirral MBE

Structure and Delivery

10. My task is to produce a comprehensive set of recommendations about the future substance of regulation: about its content and also about the manner in which it is enforced. From the very outset, however, it has been clear to me that there is widespread concern – amongst practitioners and purchasers of legal services and also within the bodies directly involved – about the ability of the current regulatory structures to deliver effective regulation. At this point I should mention *en passant* that, in the second phase of this Review, **I do intend to consider whether the edges of the regulatory "net" should be extended, for instance to cover will-writing, certain commercial work, certain types of legal helpline and all probate work. I should be especially interested to hear your views on this matter, in particular with regard to the criteria that should be applied to the regulatory "net".**

11. Let us go back to first principles. Whether it is rule-based or principle-based, regulation exists, first and foremost, to prevent detriment both to the consumer and to the wider public interest. This is asserted on the face of the Legal Services Act 2007 (henceforth "the Act"). The principal task of the regulatory structure is to establish a set of standards below which no regulated individual or entity may fall. In the field of legal services it must do so with reference to the clear regulatory objectives set out in Section 1 of the Act, which serve to remind us that the public interest comes first. There will be suitable systems of rewards and, more appositely, sanctions available. In contrast, the role of a professional body is to set professional standards that are higher and more aspirational. Perhaps as a consequence of the legacy of self-regulation, many within the profession are still unclear in their own minds about the distinction between regulatory requirements and professional standards. This problem cannot be solved overnight, and there may be a need for some reform of legal education and training. **I should be very interested to hear your views on how and when ethical matters should be introduced**.

12. Professional standards are perhaps the major differentiator between legal professionals and mere providers of legal services. The acceptance and

understanding of those standards do not necessarily come, as if by some process of osmosis, through the study and discipline of the law. The profession needs to educate and guide its members in the responsibilities of being a professional - from legal training, through qualification and throughout their working lives. Continuing Professional Development has, in my view, a key role to play here. Similarly, the mere publication of a rulebook and associated materials is insufficient for a modern regulator to gain assurance of regulatory compliance. An effective regulator will be looking to achieve a working partnership with regulated entities that is founded upon an expectation of compliance and supported by guidance, advice and training materials that assist in ensuring that compliance.

13. The process of separating regulatory and representative functions within the auspices of the Law Society began even before Sir David Clementi had delivered his final report. This represented an admirably bold attempt to anticipate Sir David's conclusions about the necessary separation between the representative and regulatory functions; conclusions which are rooted both in natural common sense and in the sceptical, questioning *Zeitgeist* of an era in which greatly enhanced transparency is increasingly a *sine qua non* for convincing legislators, commentators and consumer groups that the regulatory structure is truly independent and effective.

14. Quite rightly, both the Law Society and David Clementi recognised that the era of traditional self-regulation by the profession had run its course. Not only must the highest professional standards of service delivery and integrity be maintained: they must also be *seen* to be maintained. We cannot be complacent about this. The genesis of the Act can be traced back to HM Treasury commissioning a report from the Office of Fair Trading a decade ago, into supposed restrictive practices in professional services. That report, *Competition in the Professions*, was published in 2001, prompting a response from the then Department for Constitutional Affairs that was highly critical of the regulatory regime at the time. Make no mistake: the death-knell had sounded for the traditional model of regulation by the profession, of the profession.

15. The Act adumbrated a new system of statutory regulation, still with a major role for the profession and retaining the Law Society as the front-line regulator, but with a clear distinction drawn between its regulatory functions and its other continuing role, as a professional body. It falls to the Law Society to make that separation, but it is the statutory responsibility of the Legal Services Board (LSB) to ensure that it does so. Section 30 of the Act requires the LSB to make internal governance rules for front-line regulators to ensure "that the exercise of an approved regulator's regulatory functions is not prejudiced by its representative functions" and also that regulatory decisions are "so far as reasonably practicable taken independently" from representative decisions. On 25 March 2009 the LSB published its consultation paper on its proposed draft rules, entitled *Regulatory Independence.*

16. In paragraph 3.10, this paper makes clear that separation must be palpable: "we suggest a requirement to ring fence the regulatory arm, not simply its power to make decisions in specific cases". Paragraph 3.26 goes further: "we suggest it should be absolutely clear that regulation is not to be controlled by people who also carry out representative functions and so who could (wittingly or unwittingly) act in a way that is wholly or mainly in the profession's interest". Rule 3 (3) of the draft Internal Governance Rules suggests that "in the event of any uncertainty, the question of whether a matter is within the regulatory functions of the independent regulatory authority shall be determined by the independent regulatory authority".

17. Writing in the *Law Society Gazette* at the beginning of April this year, the President of the Law Society, Paul Marsh, rightly observed that "the experience of the last three years or so has been extremely valuable … With the legislation now settled and the LSB in place, it is an appropriate moment to take stock of progress and lessons learned". In the foreword to the LSB consultation paper, the Board's Chairman, David Edmonds, emphasises the importance of how the system is perceived, as well as how it operates in practice: "Our work now is about ending, once and for all, any perception that lawyers run the regulatory system for themselves … It is about entrenching a regulatory agenda that is in the public and consumer interest". However this

debate ends, let us hope it ends soon and also with the unmistakable emergence of a robust, fair and sustainable system, which promotes parity of esteem for the "two pillars" of the Law Society, namely its regulatory and representative functions.

18. The LSB states, rather ominously, in paragraph 10 of its Business Plan for 2009/10, if the model of professional-led statutory regulation envisaged by Parliament fails, "the very real likelihood is wholesale statutory regulation, with a progressive loss of public confidence in the concept of a profession". Some would see that as a threat, but for my money it underlines the fact the LSB was not established to micro-manage front-line regulation. In fact it is intended to be far more Olympian than that. As I said in the House of Lords on 6 December 2006, the LSB should be "a regulator of last resort, no more and no less, and that should be made penny plain in the Bill … intervention should be the exception not the rule". This cannot restated often enough. The independence of our legal system from the executive was established by Magna Carta. It must remain the touchstone of the system, but we cannot, must not and dare not ever be complacent about that.

Partnership

19. Once both the reality and the perception of separation have been settled and entrenched, it is to be hoped the boundaries between the two functions will be too. The regulatory pillar of the Law Society will set regulatory standards. These are mandatory and those who fall below them have sanctions applied. This creates an historic opportunity for the representative pillar of the Law Society to establish itself as the very model of a professional body, unshackled from its regulatory function and able to commit itself to the development, promulgation and, where necessary, enforcement of professional standards and able to be a real force for improvement in regulation through its clear, professional and representative voice. There will be a huge need for partnership between the two pillars. Where the regulatory pillar may, for instance, take responsibility for setting the standards for matters such as accreditation and Continuing Professional Development, the delivery

of schemes, to standards acceptable to the regulator, may be a matter for the professional body. Effective accreditation can boost professional standards and help to obviate the need for tiresomely intrusive regulation.

20. Whilst the regulator is interested in improving regulatory compliance, the professional body has a duty to build on this base by encouraging higher standards, in particular ethical standards. It is in everyone's best interests for the two pillars of the Law Society to work together in creating efficient mechanisms for educating and accrediting the professions. Indeed this is a classic instance of where the regulator and the professional body should conduct an ongoing and amicable dialogue, in order to resolve any potential outstanding "boundary disputes" as quickly and painlessly as possible. This is important for the consumer as well as for the profession: for example, clarity about what ‘accreditation’ means must be readily explicable to those purchasing legal services. The regulatory pillar of the Law Society is already doing some excellent work in this area.

21. There are clear lessons to be learned from other sectors about where the dividing lines naturally sit. One interesting question is which part of the Law Society should have the power to bestow and, *in extremis*, to remove the title of solicitor. I also believe there may be a need for greater clarity about what it means to be a solicitor; use of the title may be taken to imply adherence both to regulatory requirements and to certain ethical standards, but is that really the case? **I am minded to recommend that only those who satisfy regulatory requirements, but also subscribe to the high professional standards promulgated by the professional body, should be entitled to call themselves solicitors. This would put the title of solicitor firmly into the "professional" sphere**, though it would surely be unthinkable for anyone struck off as a consequence of a regulatory (rather than "professional") breach or breaches to carry on describing himself or herself as a solicitor. The title should be in the gift of the body setting the higher standards – namely those with the more demanding ethical content – which should be the professional body within the Law Society.

The Substance of Regulation

22. Now I turn to the substance of regulation. It is sad to report that I and my team have received all too few complimentary comments about the current regulatory arrangements. An adjustment of sorts must be made, of course, because those who feel dissatisfied, aggrieved or disenfranchised are disproportionately likely to respond to reviews of this kind. Nonetheless, there are plainly aspects of the current substance of regulation that unnecessarily antagonise the profession, without producing clear and demonstrable benefits for the consumer, or the wider public interest, in whose cause the structure exists. The regulator must not be controlled by the community it exists to regulate, but it must command its respect and confidence. Time and time again I have heard how the Solicitors Regulation Authority (SRA) and its activities are still too reactive; and too closely related to complaints and lapses. I do not necessarily blame the SRA for this: to a very great extent, this is its cultural inheritance, having said which no organisation should be in thrall to its past. There are various programmes of reform already underway within the SRA, but I cannot refrain from suggesting one or two more.

23. In considering regulations I find myself always drawn back to the five basic principles for regulation set out by the Better Regulation Executive (BRE) and, before it, the Better Regulation Task Force. These are restated in sub-section 28 (3)(a) of the Act, which asserts that regulation should be proportionate; accountable; consistent; transparent; and targeted. Regulation is not about the exercise of arbitrary power. Regulators must challenge those they regulate and they must keep them on their toes, but that can be a positive experience for all concerned, so long as those five principles are adhered to. Every regulator has a duty to be properly accountable for the stewardship of its budget, staff and premises, and also to bear down on the costs of compliance. Regulators such as the Financial Reporting Council have worked extensively on this. They should also bear in mind those principles which are most easily forgotten, such as accountability. **I am minded to recommend that, in its annual report, the SRA should explicitly chart its progress across the year, judged against the five BRE criteria.**

24. Perhaps the biggest question going forward is whether and how the SRA can become more pro-active, sharing with the world not only its responses to breaches of regulations, but also its clear vision of how a good legal firm should look, operate and behave? There are hints of this more positive approach in the SRA's first strategic plan, but I believe the SRA still has some way to go in this regard. Furthermore, prevention is better than cure **and I am currently minded to encourage the SRA to strengthen and redefine the role of the Practice Standards Unit, developing a comprehensive "compliance tool kit" for firms and extending the role of pre-emptive and advisory visits to firms (especially those deemed to be "at risk") to help with compliance, seeking to prevent regulatory breaches occurring.**

25. The Macrory Review, set up following recommendations made in the final report of the Hampton review on regulatory inspections and enforcement, reported in November 2006 and took forward the risk-based approach, underlining the need for regulators to have a flexible set of penalties available to them. Macrory's emphasis was on transparency and the need for improved flexibility of the tools available to regulators as methods of improving compliance, rather than simply stiffening penalties. The respect of the profession will, I am sure, be enhanced by absolute transparency of operation wherever possible, combined with an empathetic approach to the challenges facing a complex and diverse profession. **I am also minded to recommend that the SRA should in future be far more explicit about the range of sanctions available to it.**

26. The day-to-day regulatory functions are rightly carried out by the regulatory pillar of the Law Society, the SRA, which possesses a range of possible sanctions, short of striking someone off the roll, but when the SRA's systems have been exhausted, the quasi-judicial disciplinary function is vested in the Solicitors Disciplinary Tribunal (SDT). The SDT is established by virtue of Section 46 Solicitors Act 1974 and is funded by the Law Society. The overwhelming majority of cases referred to the SDT come from the SRA, but it is independent of both pillars of the Law Society. This independence is essential. The Tribunal is a critically important, if rarely-discussed, element

within the regulatory framework, undertaking so much of the necessary work when solicitors fail to discharge their professional duties honestly and reliably.

27. Given the high stakes involved for those concerned, the SDT should endeavour to speed up its processes so far as possible. Unnecessarily protracted cases before the SDT are in no one's best interests, least of all those of the practitioners concerned. Good reputations, though hard won, can be all too easily lost. Magna Carta may establish we are innocent until proven guilty before the courts, but a practitioner subjected to a prolonged process before the SDT may have his or her reputation irrecoverably damaged, regardless of the eventual outcome of the case. There is potentially much expense involved too. **I am minded to recommend that, in the public interest and specifically in the interests of more effective regulation, whilst retaining the SDT's independence, regulators should ensure that valuable lessons from its rulings are noted, learned and promulgated, if necessary on an anonymised basis.**

28. As well as taking up the figurative cudgels on behalf of the consumer or public interest, regulators should deal efficiently and courteously with the legitimate enquiries and demands of those they regulate. Though there are inevitably tensions and will be disagreements or even confrontations, this is not a "conflict situation". The better the relationship between the regulator and the regulated, the more smoothly the system will work, in the best interests of all concerned. This demands that *all* the five principles above must be borne in mind by the regulator, in order to minimise friction, aggravation and disagreement, none of which serve the public interest.

29. Responses to this Review have focused overwhelmingly on the inspection and/or monitoring role of the SRA but scarcely mentioned the contents of the SRA Solicitor's Code of Conduct ("the rulebook"). **I should like to use this second phase of consultation to press stakeholders for their views on the contents, the tenor and the general accessibility of the rulebook.** It may be that they are all content with it, but I am not comfortable interpreting silence as acceptance, still less as enthusiasm.

30. A number of individuals engaged in trainee development have made submissions to the Review, in which they have lamented the lack of consistency in the advice they receive from the SRA call centre. They speak of regularly having to obtain "second opinions" when they feel uncertain and compare this unfavourably with the previous system, wherein they had a dedicated number and spoke to same individual or individuals every time, whom they knew by name. There was no inherent risk of "regulatory capture" in this: it was simply a more efficient and reliable system. **I am minded to recommend that the SRA should seek to enhance the quality and consistency of the service it offers by once again providing its regulated community with named individuals and/or groups with whom to deal, in place of the existing, rather anonymous, call centre.**

31. The regulator should also err on the side of transparency and openness with regard to the regulatory risk criteria it applies, and also its enforcement activities. It should be mindful too of the oft-made criticism made of it, that its activities focus disproportionately on certain types of firm. Were the SRA to be more transparent about the criteria it applies, this complaint might evaporate. Having said which, there are inevitably fixed costs associated with satisfying the demands of regulation, and smaller firms find these harder to absorb. Greater transparency about SRA processes might help them to avoid the pitfalls in the first place, reducing the regulatory burden significantly.

32. Successful and appropriate regulation requires that the regulator should be seen as impartial - "blind", as it were, to aspects of firms that are not germane - and it seems to me that it is in the public interest as well as in the interests of efficient regulation that that there should demonstrably be no hint of inequality of approach or practice by the regulator. It follows that no area of legal practice should be regulated more rigorously than any other, unless a clear risk-based case can be made for it. Above all, rules, codes of conduct and the like should be drafted and applied on a consistent basis. I have been struck by the number of submissions to me that have indicated a level of perceived discrimination on the part of the regulator.

33. Whilst I applaud the progress in this area following the report by Lord Ouseley, I consider that this sense of discrimination may be reduced if unresolved complaints about regulation could be referred to a more obviously impartial adjudicator. **I am minded, therefore, to suggest that the regulator should set up a completely separate function to consider such complaints against the regulatory arm. The model I have in mind is akin to that of the Office of the Complaints Commissioner, set up under the Financial Services and Markets Act 2000 to provide a means by which the regulated community could have an independent adjudication on complaints against the Financial Services Authority.** It is not the first port of call and the regulator itself must have the opportunity to address the complaint itself before the adjudicator may accept the complaint.

Appropriate Regulation: Common Principles, Varying Methods

34. As the BRE regulatory principles are more widely proliferated and assimilated, regulation is becoming less prescriptive and rule-based and much more risk- and principle-based. I strongly favour this, but it does create a new concern. The legal profession is characterised and, increasingly, dogged by numerous and overlapping codes and sets of professional and (sometimes quasi-) regulatory principles. This is part of what the Government has rightly termed the "regulatory maze". I am persuaded by the view that this jungle of standards, codes and principles now needs urgent simplification; that everyone would benefit from greater simplicity. Given palpable and robust separation between the regulatory and representative functions within the Law Society, **I am minded to recommend that there should be just two codes and/or sets of principles: one each for the regulator and the professional body**. They should be designed to complement one another. Each should take full account of the other and both must be sufficiently flexible to allow for the gradual introduction of ever-higher standards over time.

35. Anyone contemplating these two codes should perceive at once the difference between the regulatory regime with its mandatory requirements and professional standards, which are inevitably more ethical in nature. I should

very much welcome your thoughts on precisely what should go into these two codes, should my proposed recommendation for streamlining and simplification be accepted. The codes should be consonant and broadly consistent with one another and they should complement each other. Though they should be demanding and worthy of this great profession, any professional worth his or her salt should easily exceed the demands of both.

36. In counterpoint to a more effective regulatory regime, there may also be a need for other functions and activities to emerge, outwith and alongside the independent regulator and the re-energised professional body. It is usually not appropriate for a professional body to provide services such as legal representation to its members. Traditionally, indemnity insurance has been able to fulfil this role in the legal sphere, but there may also be a role for a new and separate "trade union style" representative function. As legal regulation acquires at least some of the appurtenances of an entity- rather than individual-based system (of which more later) I suspect we may also see the emergence of a trade association with corporate membership. There may also be a case for a Legal Defence Union for individual solicitors, whose indemnity insurance cannot – and indeed should not – protect them against the possible consequences of regulatory breaches.

37. I deal with Alternative Business Structures later on in this paper, but I do feel it is worth noting that non-legal staff working within those will be expected to meet professional standards, so I imagine they too will aspire to belong to a professional body in due course. ILEX currently does a splendid job representing Legal Executives (and also regulating them within a separate internal "pillar") and perhaps a similar arrangement will emerge for individuals within ABSs who enjoy comparable seniority and status, but whose activities are outside the legal sphere – either under the ILEX aegis (perhaps at affiliate grade) or outside it. These are not strictly regulatory matters, but they are of interest to this review insofar as they have a direct and demonstrable impact upon the functionality and internal governance of the Law Society and, by implication, upon the effectiveness (or otherwise) of regulation.

38. I read the report by Nick Smedley into the regulation of corporate work with great interest and continue to digest its various arguments, conclusions and recommendations. **It may well be that the Smedley conclusions set out a useful direction of travel, but I do not believe they should be acted upon hurriedly or in isolation and I should like to take the opportunity to dovetail his useful work into my wider Review.** At this stage, I am reserving my position with regard to his notion of establishing a separate regulatory structure for a particular type of firm, either within or outwith the structure of the SRA. It is important to bear in mind that, even as the focus of regulation moves away from regulation of individuals and towards entity-based regulation, it will ultimately continue to focus on the nature of activities and not on the nature of clients. **I find it a compelling point in Nick Smedley's Report that appropriate regulation can be carried out only by individuals and teams who possess the appropriate expertise, relevant to the nature of the firms they are regulating and/or investigating.**

39. **Whilst I recognise the strength of the argument for a substantively different form of regulation for large, corporate firms, I am inclined to agree with Nick Smedley that it is unlikely this can best be addressed by means of setting up a separate, bespoke regulator.** However this is approached, we must be always mindful of the danger of so-called "regulatory capture". This is another risk that must be managed, and taken into account when forming a final view on how to proceed in this area. My first principle is that all firms in the sector should be subject to the same basic principles, regardless of the supposed nature of their clients. This is stated clearly in Section 1 of the Act. It should also be borne in mind that there is no such thing as a "free" regulatory structure. All of this must be funded by the profession and, ultimately, by the consumer, so a rigorous cost-benefit analysis must be applied to any significant changes in the regime.

40. No one from Clementi, through ministers and the Act to the LSB and the SRA has argued for a "one-size-fits-all" regulatory regime, but the founding principles set out in the Act must by definition be universal. The LSB consultation paper *Regulatory Independence* emphasises that the issue at

hand is "about the proportionate way to *apply* principles in the light of individual organisations' circumstances". To put it another way, the regulation of any individual or firm (in this or any other regulated sector) should be closely related to his, her or its activities and to the risks they may present to clients, to the regulator and – in this case – to the profession too.

41. With regard specifically to the larger, so-called corporate firms **I am inclined to agree with Nick Smedley's conclusion that they require a different approach to that adopted for smaller firms. I am currently very attracted by a system of "mandatory self-regulation".** This works very well as a finely-tuned and highly proportionate form of regulation for substantial firms in certain other sectors, and I believe it could serve admirably as a means of delivering the clear, statutory regulatory principles set out in Section 1 of the Act. It is also, one might argue, the basis of the relationship between the LSB and the front-line regulators. Firms would be required to self-certify their adherence to regulatory requirements annually and named individuals would be responsible for ensuring that processes and data were all presented in an accurate and timely fashion.

42. A separate unit of the regulator, staffed by suitably skilled and experienced individuals, would manage such a system and regularly assess each firm's compliance with the regulator's standards every three years. There could also be on-site regulatory checks along the lines of the Financial Services Authority's "Arrow visits". This proposed new system should in no way be mistaken for a "get out" or a "light-touch" regime: the penalties for infractions within such a system can and should be extremely severe – both for firms and for individuals. It could in time become a mark of pride to be admitted to this system, something to which every law firm might ultimately aspire – a mark, perhaps, of corporate maturity. Compliance failure, on the other hand, could imply that a firm is no longer suitably equipped – by virtue of inadequate systems, processes, or culture – and that therefore continued self-certification would no longer be appropriate, and the firm would revert to "mainstream" regulatory supervision.

43. Readers may have discerned an emerging theme in this document, namely that the regulator should take a far greater interest not only in the services provided by law firms, but also in the robustness of their internal governance arrangements. I believe this would mark a great leap forward, marking a break with the complaints-led culture that can further aggravate the potentially fractious nature of the relationship between regulator and regulated. Perhaps most importantly, this change of culture could prove invaluable as the regulatory structure girds itself up for dealing with perhaps the biggest challenge it has ever faced, to which I now turn my attentions.

Alternative Business Structures

44. First of all, I must admit to having some "form" so far as Alternative Business Structures (ABSs) are concerned. David Clementi was very cautious about what he termed Multi-Disciplinary Practices (MDPs). He saw the attractions of a more liberal model in terms of bringing capital into businesses and providing more of a "one-stop shop" of professional services, but the regulatory challenges gave him grave cause for concern. He drew the important distinction between law firms bringing in outside managerial expertise "to enhance the services of the law practice" and combining with other, non-legal professionals to provide services to the public. This latter form of combination demanded the creation of new regulatory safeguards and structures that he felt were outside his remit.

45. Ministers, notably the then Lord Chancellor, Lord Falconer, were far more sanguine, however, and it fell to the Joint Parliamentary Committee that I chaired in the Spring of 2006 to recommend a "step-by-step" approach to the introduction of ABSs, based upon truly risk-based regulatory principles. We also ventilated the principle that the entire ABS, and not merely its strictly legal functions, should be subject to regulation, by a single regulator, licensed by the LSB. This system will indeed be applied. Indeed it is already in operation, so far as the relatively small number of Legal Disciplinary Partnerships (LDPs) are concerned. LDPs are regulated as entities by the SRA and the lawyers within them are regulated individually by their own designated regulator.

46. In the House of Lords on 6 February 2007 I again urged caution, on behalf of the Committee urging the Government to "use less haste and more care" in the gradual introduction of ABS firms. My plea fell on deaf ears and consequently the full advent of ABSs may come as soon as 2012 or even 2011. Regulation, like politics, is the art of the possible, so we must make the best of the world as it is, not as we might wish it to be. The first question to resolve is whether ABSs will necessitate the formulation of an entirely new regulatory model. It is left to the LSB to determine the overall framework of regulation, and thereafter to individual regulators to resolve how, and indeed if, to issue licences. This is *terra incognita* and risk assessments are all going to be on the high side. Should there therefore be some kind of surcharge or levy on the first wave of ABSs, to take account of high attendant risks?

47. It could be argued there is a paradox at the heart of the Legal Services Act and the system it seeks to inaugurate, in that a renewed and strengthened regulatory structure is being introduced just ahead of such a radical and innovative act of liberalisation. I continue to believe there is a significant possibility that ABSs may create potential consumer detriment, unless the structure for regulating them is fully up and running before they are. To put it another way, I remain to be convinced of the benefits that the rapid introduction of ABSs will bring to the consumer or to the wider public interest, which to me remains very much a "case unproven".

48. Especially where outside ownership is being contemplated, or in the case of new entrants to the market, the regulator must think in terms of really robust conduct of business rules**. I am minded to recommend that all ABSs should be required to appoint a designated Head of Regulatory Affairs, at board level or equivalent.** This well could be the senior or managing partner (if there is one), the Head of Legal Practice or the Head of Finance and Administration. The regulator may also need to ask some searching questions – including personal interviews – about the suitability of the individuals involved, along the lines already adopted by the Financial Services Authority.

49. I well understand the impatience of the LSB, but I am also mindful of the practical and logistical reservations the SRA has openly expressed. This is not only a question of how existing organisations will adapt to changed circumstances: in my final recommendations I shall seek to focus on the likely regulatory challenges that will be created by the advent of entirely new entrants to the legal services market. **Certainly there must be no question of the regulator being forced to regulate ABSs unless and until it feels genuinely confident about its ability to do so, to the highest standards.** The regulator will have to be particularly clear about the information it requires, the scrutiny it intends to undertake and the sanctions it might impose.

50. ABSs in their entirety should be expected to match the ethical standards we have rightly come to expect of traditional law firms – both the regulatory and also the professional standards. The concept of a "controlling mind" can be found elsewhere in statute and the regulator may wish to ensure that the "controlling minds" within an ABS are fit and proper. It may come as a culture shock to many of those involved, but important criteria such as the imposition of rules relating to conflicts of interest, client confidentiality and the handling of clients' money must be maintained right across the sector, including that part of it populated by ABSs. To put it another way, the ideal regulatory test for ABSs may not be how different their practices are from the best practices in traditional law firms, but how akin to them they can successfully aspire to be. Regulation is ultimately of activities, but robust requirements on good governance, applied to all aspects of each and every ABS, should ensure that only appropriately trained, qualified and supervised individuals provide regulated services to consumers. That is how consumer detriment can be prevented, and the public interest protected and advanced.

51. The issues of ownership and access to new forms of capital are significant, but I believe they are manageable. However, the new enterprises envisaged in the Act imply new methods of working as well as new business structures for the delivery of legal services. New methods of working should not lead to a weakening of regulatory oversight, and I am struck by the number of representations that I have received, expressing fear that it might do precisely

that**. I am minded to recommend that Alternative Business Structures should initially be subject to the same rigorous standards of governance and mandatory self-regulation that I propose for corporate legal firms; this approach to be reviewed after a period of, say, five years.**

52. These are early days for the LSB and I hope I shall be able to make a useful contribution to its thinking about how to regulate ABSs, in particular their reserved activities. This is the toughest nut of all to crack and I am planning further meetings not only with existing players from the legal services market, but also with those who have expressed an interest in moving into the sector for the first time, once the ABS regime is in place. I have no desire to stand in the way of innovation, where that serves the public and consumer interest; I am concerned only to ensure that professional standards are maintained, and public detriment avoided wherever possible. I hope to hear the views of stakeholders on this and other matters at the road-shows I am undertaking across England and Wales during May and June 2009.

53. Best practice, in terms of conflict management, risk management and personnel management, must be encouraged at every turn. Of course, what ultimately matters is outcomes not processes, but the latter in so many cases shape the former, and sub-standard internal governance arrangements are all too likely to deliver sub-optimal outcomes for consumers. I want to see clear**,** principle-based and outcome-focused regulatory requirements, allied with a modern professional code and the authoritative promulgation of best practice in internal governance.

54. Regulation necessarily makes demands, but if it satisfies the five principles of the BRE, as restated in Section 3 of the Act, it need not be a burden. The best practitioners should not be looking tremulously down for fear of failing to satisfy the basic standards set by a regulator; they should be aiming high, aspiring to satisfy and ultimately exceed the highest professional standards.

Further responses should be sent by the end of June 2009, preferably by email to legalregulationreview@beachcroft.co.uk, or by hard copy to:

Rt Hon the Lord Hunt of Wirral MBE
Legal Regulation Review
c/o 100 Fetter Lane
London EC4A 1BN

Responses will be treated as confidential during the consultation period and any material from them will be quoted and attributed subsequently only with the express permission of the individual or organisation concerned.

Lord Hunt and members of his team will be undertaking the following road-shows:

Manchester	7 May 4.30pm - 6.30pm
Birmingham	8 May 3.00pm - 4.30pm
Cardiff	14 May 4.30pm - 6.30pm
Bristol	15 May 2.00pm - 4.00pm
Leeds	19 May 3.00pm - 5.00pm
London	27 May 6.00pm - 8.00pm
Liverpool	26 June 2.00pm - 4.00pm

Book your place online at **www.lawsociety.org.uk/events** or e-mail **events@lawsociety.org.uk** confirming which event you wish to attend, along with your name, job title and organisation.
Spaces are limited so please book early.
Please let us know if you have any special access requirements.