



**RESPONSE TO THE
REVIEW OF
LEGAL SERVICES
REGULATION
CALL FOR EVIDENCE**

2 September 2013

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SUMMARY

This document sets out the Council for Licensed Conveyancers' (CLC) response to the initial call for evidence from the Ministry of Justice to inform the review of regulation of legal services in the context of the government's wider Red Tape Challenge. An annex provides background information on the CLC.

We set out proposals for two quick wins and six medium term goals.

Quick wins

- 1. End double regulation of legal services** – ensure that regulation by the legal services regulators and those in the financial and other sectors do not overlap in ways that inhibit the free functioning of healthy, competitive markets
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- 2. Rationalise PII requirements for innovative firms** - changes to PII practice that currently inhibit the free functioning of the market and the development of new business models .
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Medium term goals

- 1. Foster flexibility to change and help drive innovation and growth** – levelling the playing field for front line regulators
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- 2. Entrench collaboration on legal education** – building on the recommendations of the Legal Education and Training Review
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- 3. Establish centralised compensation arrangements** – to enhance consumer protection pending a review of the workings of insurance and compensation schemes
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- 4. Rationalise regulatory objectives** – the current framework contains too many, conflicting objectives
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- 5. Set out principles for the reservation of legal activities** – a thorough review of what actually needs to be regulated in light of risk of actual detriment
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- 6. Complete the separation of regulatory and representative functions** – to ensure objective regulatory decision-making
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INTRODUCTION

We welcome this review. It presents a valuable opportunity to make some seemingly small but actually fundamentally important changes to the regulation of legal services in light of a few years' experience of the operation of the Legal Services Act 2007 (LSA) framework.

To a large extent it is premature to make any firm determination about the overall framework established by the LSA. Its purpose of bringing about significant change in the legal services market is only beginning to be realized and needs more time to play out. A single regulator was rejected then, just six years ago, for both philosophical and pragmatic reasons based on a thorough study of the models of regulation available. It is difficult to see what has changed in a few short years that would cause us now to consider a radically different direction than the course set by the LSA. Compromises in the drafting of the LSA may well have created obstacles to the achievement of the consumer-focused objectives of the original framers of the legislation. However, rather than tear up the Act now, there are adjustments that can be made that will help to achieve better its original objectives and we look at some of those at page 7 and 8 of this submission.

The freedom to innovate and find new ways to meet consumer need have been taken up slowly by the market, in part as a result of the economic downturn since 2008. It is only a few short months since the first ABS firms came into existence. Their new freedoms have not yet been fully explored or exploited and any change that risks stifling that positive evolution should be avoided until the new legal services market is more mature.

Another few years of uncertainty about the future of regulation of legal services that would surely arise from the introduction of a new act of parliament on the subject, would almost certainly lead to a blight on the development of the market. That is why we are making in this submission proposals for practical steps that can be taken easily and quickly to build on and improve the current framework. This we believe is more realistic and effective than a protracted process to develop a new framework for regulation so soon after the LSA 2007.

We do not discount the possibility that there might be a case in the future for a single regulator of all legal services. However, we believe that there is a continuing and important role for a range of regulators developing diverse approaches to regulation – always with the protection of the consumer and public interest in mind – to help foster change and innovation in the sector, subject to appropriate oversight by the Legal Services Board. Having a range of regulators allows different approaches to emerge that can support innovation and specialisation. For now, that is how the consumer interest can best be served because diversity of regulatory regimes has delivered benefits to consumers by supporting competition in the legal sector.

While we do not believe that it is now time for sweeping change, it should be possible to identify how the existing powers could be applied more effectively, whether there are any significant gaps or inconsistencies and what small changes could support a more smoothly functioning market to deliver innovation in regulation of legal services.

TWO QUICK WINS FOR THE LEGAL SECTOR

We begin by setting out two issues that represent problems across the legal sector. The CLC considers they need to be addressed actively by the legal regulators working together and that the LSB has an important role in facilitating those discussions.

These issues, relating to the influence of lenders and practice around professional indemnity insurance have a direct, immediate and inhibiting impact on the functioning of the legal services market.

End double regulation of legal service providers

The work of the front line legal sector regulators can overlap with that of regulators in the financial or other sectors. To achieve a coherent and proportionate approach, all regulators need to cooperate and support the functioning of healthy and competitive markets. There is a current, acute example of this in relation to conveyancing.

The increase in the incidence of mortgage fraud in other parts of the legal services market coupled with a change in regulatory approach has resulted in lenders being more risk averse. Some lenders have reduced the number of practices on their panel by removing practices which, in the lender's terms, it has instructed infrequently and by not instructing particular classes of practice if the value of a mortgage is above prescribed limits. Lenders have hitherto generally accepted the premise that they instruct the lawyer instructed by the borrower. However, the change of policy means that in many cases the borrower ends up instructing the lender's preferred lawyer.

New entrants are often not allowed onto lenders' panels because they have not previously been instructed by the particular lender. Some lenders extend restriction to practices which transfer regulator even though their personnel are unchanged and they are meeting requirements overseen by the LSB.

To help address this, we have seen the establishment of the Conveyancing Quality Scheme (CQS) by the Law Society (NB: not its regulatory arm the SRA). The CQS places additional checks on solicitors carrying out conveyancing work as a means of reassuring consumers (individuals and institutions alike). Lenders also have in place their own criteria – largely based on size of practice or numbers of transactions undertaken – which they apply to solicitors and licensed conveyancers alike. This is disappointing given the CLC and its regulated community's excellent record on fraud management.

These actions amount to double regulation in the sense that regulated lawyers are having to meet two or sometimes even three sets of separate requirements. These additional quasi-regulatory burdens are being placed on practitioners who are judged by the front line regulators, acting under the oversight of the LSB and MoJ, to be fit to practise.

Lenders may be seeking to address real risks but we would contend that these are better addressed within the framework of regulation, with all the safeguards provided by the full regulatory framework around proportionality and consumer interest. Ad hoc actions by lenders are not subject to those controls.

The CLC has begun discussions with lenders and their representative bodies to see whether and how the risks that lenders wish to mitigate could be addressed through the regulatory framework rather than ad hoc arrangements that can differ from lender to lender, result in

unfair treatment of practices and individuals, place additional burdens on the sector and inhibit competition and innovation.

We believe that a more general, sector-wide effort is needed to resolve this problem bringing together the front-line regulators and the Legal Services Board with the FCA and PRA and lenders' representative bodies.

Rationalise PII requirements for innovative firms

At the moment, the transfer by a practice to another regulator is treated for the purposes of professional indemnity insurance as a cessation of business by its past regulator. The practice is then required to take out run off cover, typically 2.5 to 3 times the annual premium payable on last renewal. That run-off cover is of course in addition to its ongoing cover for its continuing business under a new regulator.

This disincentive to changing regulators is wrong and makes the objectives of the legal services act all the harder to achieve, inhibiting the free operation of the market and the evolution of the legal services offering to consumers.

MEDIUM TERM GOALS

Foster flexibility to change and help drive innovation and growth

This is a major priority for the CLC.

The CLC's statutory framework based on the 1985 Administration of Justice Act remains unnecessarily prescriptive. It inhibits the CLC from moving quickly to innovate. This has a direct adverse impact on the CLC regulated community and has a potentially deterrent effect on those who might wish to apply to be regulated by the CLC.

The CLC would like to move to a position (very similar to the powers contained in the LSA) where the terms of its enabling legislation were sufficiently flexible to enable it to make the necessary rules and regulations to cover any approach it may wish to take to any type of legal regulation, subject to appropriate consents from the oversight regulator. This is the framework within which other regulators operate and we can see no argument for there not being a level playing field for all regulators and the businesses they regulate.

Entrench collaboration on legal education

The Final Report of the Legal Education and Training Review¹ has recommended the establishment of the Legal Education Council forum for greater collaboration. It suggests a number of roles for such a council. We suggest there should be a scoping study to investigate the roles of such a Council and alternative options for delivery of those roles.

Consumers need to be satisfied that the Authorised Person handling their legal matters is competent to do so. We believe that the LSB has a role in setting standards of education and competence that should apply to all Authorised Persons with the front line regulators then setting the education criteria for those persons based on the activities regulated by them.

Establish centralised compensation arrangements

Currently only the SRA and the CLC have established compensation funds, although we understand that other regulators intend to set up their own fund. The CLC believes that the scope for a centralised Compensation Fund should be investigated². If there are to be compensation schemes across the legal sector, we believe that a centralised solution offers very considerable benefits:

- Simpler access for consumers to a standard scheme;
- Extension of financial protection to the clients of those legal services providers currently without such a scheme (that is to say all, but licensed conveyancers and solicitors);
- Independence and consistency of decision-making, divorced from funding considerations

¹ <http://letr.org.uk/wp-content/uploads/LETR-Report.pdf>

² <http://www.legalservicesconsumerpanel.org.uk/ourwork/Financial%20Protection/FPAs%202013%2006%2010%20final.pdf>

However, the time may be approaching for a more thorough-going review of how insurance and compensation funds work together to protect the consumer and whether the current arrangements offer the right balance of protection without unwarranted regulatory burden. Is there any evidence, for example, that the existence of a compensation fund removes moral hazard while costing the profession money? We note that the current LSB business plan commits to consideration of advice from the Legal Services Consumer Panel on financial protection arrangements.

Rationalise regulatory objectives

The LSA sets out eight regulatory objectives. Most other regulatory regimes have half that number. Despite guidance provided by the LSB, it is not clear what they mean. They can be inconsistent. We do not believe it is sufficient to argue that different regulatory objectives will be relevant depending on specific circumstances. Clarification of the objectives will assist in determining the principles underlying any decision as to which legal activities should be regulated.

As we have remarked elsewhere in this submission, the proposal for a new regulatory objective – to support economic growth – is welcome but is also subject to the comments about the need for coherence in the full set of objectives and its application to all regulators in the sector.

Set out principles for the reservation of legal activities

In two papers³ the Legal Services Institute has highlighted the fact that there are no agreed principles determining which legal services are designated reserved legal activities and that the scope of reservations is outdated. We believe that a root and branch review should be undertaken of the scope of legal services which are regulated starting from first principles. The presumption should not be to increase the scope of legal activities, but rather to identify the potential detriments to the consumer or public interest which needs to be mitigated in relation to different legal services. As the Lord Chancellor pointed out in respect of will writing, reservation may not be the best solution. The unregulated legal services market is expanding rapidly and one solution may be to have different intensities of regulation which may be determined by the activity, or by the nature of the particular recipient of legal services.

Complete the separation of regulatory and representative functions

The LSA requires rules to be made ensuring that regulatory functions are not prejudiced by the representative functions⁴. The CLC understands that further work is required so that the culture across the legal services sector acknowledges and accepts the requirement for separation. This remains a very important aspect of the LSB's responsibilities. The three main regulators (unlike the CLC) were born out of the professional bodies whose members they now regulate. They still need time to establish themselves fully and this needs to continue to be monitored by the LSB.

³ Reserved Legal Activities – History and Rationale August 2010 (http://www.thelegaleducationfoundation.org/wp-content/uploads/2013/06/LSI_Aug_2010_Reserved_legal_activities.pdf) and What is the Case for Reservation July 2011 (http://www.thelegaleducationfoundation.org/wp-content/uploads/2013/06/LSI_Jul_2011_The_regulation_of_legal_services_What_is_the_case_for_reservation.pdf)

⁴ S.30 LSA

ANNEX

About the CLC

The Council for Licensed Conveyancers (CLC) was established by the Administration of Justice Act 1985 (AJA) to regulate licensed conveyancers in England and Wales in the provision of conveyancing services. The CLC is designated one of the Approved Regulators in the Legal Services Act 2007 (LSA). We have extended our regulatory expertise to cover other legal services including probate (in 2008) and Alternative Business Structures (in 2011 when the CLC became the first Approved Regulator designated as a Licensing Authority to license ABS).

The CLC currently licenses 1,200 individuals and 200 entities, respectively accounting in 2011 (the CLC estimates) for about 4% of authorised persons and 5% of all entities in the legal sector. Those individuals service 10-15% market for conveyancing – transactions with a value of around £11bn-£15bn each year - and 20% of all re-mortgaging activity⁵. Over 70 licensed conveyancers are now licensed also to provide probate services. A number of CLC entities provide probate as well as conveyancing services and some entities have now been licensed which only provide probate services.

The CLC's Approach to Regulation

Unlike the other legal regulators⁶, the CLC has only ever had an exclusively regulatory function. The CLC's Code is principles based and outcomes focused. Created in order to foster competition in the provision of conveyancing, we still aim to support innovation and growth in the sector we regulate. We welcome the proposal in the Deregulation Bill that regulators should have an objective to support growth. We note that, as drafted, the Bill allocates that objective only to the Legal Services Board and SRA. We would expect there to be a uniform strategic approach to the regulatory objectives in legal services across all regulators. We hope this can be amended as the Bill progresses.

The specialised scope of activities its licensed entities provide has enabled the CLC to develop a substantial body of expertise and experience in activity based regulation, rather than by concentrating solely on the regulation of individuals. We are confident that our specialist focus – and that of the professionals that we regulate - is a significant contributory factor to the extremely low incidence of fraud within the community that we regulate.

The CLC's Current Initiatives to simplify Regulation

The CLC is in the course of making an application under s.69 LSA for amendment to its statutory framework to provide:

- (i) power for the CLC to issue standalone licences. The CLC considers that its power to issue licences should be modified so it is no longer a requirement for an individual seeking a probate or litigation licence to also hold a conveyancing licence. A licensee with a probate licence would need to have a conveyancing

⁵ Derived from data in Legal Services Part 3 – Key Markets, Law Society July 2013 and based

⁶ With the exception of the Master of Faculties

licence only if that licensee also intended, for example, to provide conveyancing services to the personal representative of an estate on the sale of a property.

- (ii) alignment of the CLC's disciplinary process when acting as an Approved Regulator (regulating licensed conveyancers and recognised bodies) with the process when it acts as a Licensing Authority (regulating ABS) so that the initial determination is made by the Adjudication Panel (currently the Discipline and Appeals Committee) which can be effected by an amendment to its regulatory arrangements and for appeals against determinations made by the Adjudication Panel are made to the General Regulatory Chamber ((currently the High Court) which requires an amendment to the AJA.

These amendments are focused at simplifying the CLC's current regulatory framework which it believes is unnecessarily restrictive and insufficiently transparent.

Impact of the Legal Services Act 2007 so far

The difficult economic position has depressed the market in legal services, and particularly conveyancing, in recent years. The new arrangements should continue to be tested and reviewed as the economy becomes more buoyant, capital to invest in change becomes more readily available and the regulatory framework is tested in a more active market.

The principal structural changes have been:

- the establishment of the LSB,
- the Legal Ombudsman and
- the roll out of ABS

We accept that to carry out these functions the LSB must have an authoritative overview of the regulatory landscape. We believe that this includes an understanding of the way in which the market is operating. This can only be achieved if the LSB commissions research which in turn leads to detailed data collection. It also involves engaging with the FCA and other relevant stakeholders. We are confident that this will provide an evidence base to inform the development of policy across the sector. We anticipate that this will include reviews of the effect on behaviours of the change to an outcomes- focused approach to regulation; Quality Schemes; regulatory costs, including the costs of compliance; the scope of reserved legal activities.

The Case for Further Reform of the Regulatory Framework

As Clementi said in his report that informed the LSA, the purpose of regulation is to ensure the market functions properly. More specifically, regulation is only appropriate if it ensures that undesirable consequences are avoided and the benefits which flow from regulation outweigh the costs of regulation.

Government should be slow to intervene because of the high risk of unintended consequences. Given the decision earlier this year not to make will writing a reserved legal activity, that seems to be the current view of Government. The announcement from the

Lord Chancellor⁷ accepted that there is consumer detriment in the market, but was not adequately satisfied that reservation was the best solution.

Even for a reasonably well informed consumer the legal services framework remains over-complex and insufficiently transparent. To an extent that does not matter provided there are appropriate and effective signposting arrangements and the consumer knows that when they are dealing with a regulated lawyer or entity

- service complaints can be determined by the Legal Ombudsman if they are not resolved with the legal services provider, and
- they can reasonably assume they can access appropriate protections (such as indemnity and compensation fund arrangements)

The Codes of Conduct for CLC practices and for SRA practices differ. The CLC's Code of Conduct is targeted on the provision of conveyancing and probate services. CLC practices may act for both buyer and seller in a conveyancing transaction (the SRA equivalent requirements are less permissive). The provisions for the payment of referral fees are different. If there is evidence of prejudice to the consumer, then clearly the regulators will have to take steps to remove or mitigate that prejudice.

⁷ 14 May 2013 at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/198838/Will_writing_decision_notice.pdf