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Review of the Legal Services Regulatory Framework

CLLS Submission to the Ministry of Justice

1. The City of London Law Society ("CLLS") represents approximately 15,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues.

2. Given the short time frame and preliminary investigative nature of the Call for Evidence, this response is pitched only at a high level. We would be very happy to work with the Ministry in greater detail if the initial Review leads it to pursue changes to the regulatory framework.

3. We do not believe the current regulatory framework is ideal. The Legal Services Act 2007 (the "Act") has not fully addressed the Clementi Review's objective of rationalising and simplifying the proliferation and complexity of different regulatory bodies in the legal sector. In relation to the solicitors profession, there is still no manageable separation of the regulatory and representative functions. The result is an unnecessarily complex and expensive regulatory framework. While the Clementi recommendations were in part driven by a desire to save costs by having common back office support for both the Law Society and the Solicitors Regulation Authority ("SRA"), the rising costs of regulation suggest this has not been achieved.

4. Attempts to comply with the Act have prompted a new and substantial inefficiency in the representative/regulatory relationship. The existing arrangements appear to generate constant tension between the Law Society and the SRA regarding the need for, and management of, regulatory resources leading to a disproportionate and costly management overhead.

5. The total cost of regulation is close to getting out of control. The SRA budget for 2014 approaches £80m, after successive annual rises since the passage of the Act. For solicitors, this is in addition to the various costs of the Law Society and the greater portion of the cost of the Legal Services Board, the Legal Ombudsman and the Solicitors Disciplinary Tribunal. The majority of these costs fall on the larger firms. For example, the SRA controls the balance of the practising certificate fee between firms

and individuals, and thereby determines the extent of any cross-subsidy that the large firms pay to support high street practitioners. The cross subsidy itself may be acceptable to larger firms as being in the general interest of the profession, but its existence and extent should be decided in consultation with the profession at a representative level rather than as a matter of regulation. While the post-Act relationship between the Law Society and the SRA is unsatisfactory, given the powers conferred on the Approved Regulators by the Act, it is difficult to see how these problems can be solved, or even ameliorated, in the short term.

6. We do not believe the current structure of the SRA enables it to regulate all sectors of the solicitors profession in a manner most fit for purpose. The fact is that the profession comprises professional organisations which have very little in common, from sole practitioners, to small high street firms, to larger regional networks, to ABS's, to firms concentrating on the corporate sector, to large international firms. In addition, it also includes in-house lawyers and government and local authority lawyers. The regulatory needs of these different sectors and their corresponding clients are very different and the SRA's attempts or ability to apply different approaches is too limited. In March 2009, Nick Smedley issued his "Review of the Regulation of Corporate Legal Work" which made far-reaching recommendations in relation to the regulation of that sector. Smedley's recommendations have either not been adopted or diluted and we feel that an opportunity for improvement in the regulation of the larger law firms may have been missed.

7. We have alluded to our view that the SRA fails to adjust the regulation it provides to the requirements of different market sectors. Nor is it clear that the SRA is agile enough to manage the implications of a significant rise in the number of ABS's, and the corresponding fall in the number of high street practices.

8. Further, we are of the view that regulation (not just representation) should facilitate the success of well run legal businesses. We believe appropriate regulation of the larger corporate/international firms is critical to maintain trust and to achieve the regulatory objective of encouraging an independent, strong, diverse and effective legal profession. But "good regulation" has to accommodate the wishes and needs of clients both here and abroad, and take into account that each overseas jurisdiction – currently – has a different set of regulations and rules that recognise (or not) professional qualifications from other countries. It is important that regulation is not an impediment to English firms operating overseas or a burden that sets solicitors at a competitive disadvantage in the international arena. Indeed, it might even be hoped that, under a new regime, the regulator would have as part of its role the creation and operation of a framework of regulation that is designed to remove all unnecessary barriers to the growth or success of firms.

9. The larger corporate/international firms – the majority of which the CLLS represents – generally recognise that their reputations are crucial to their continuing success and have, of their own volition, established risk management and quality assurance processes which, in many cases, are very sophisticated. It is in the interests of them all that none of them does anything which damages the reputation of – in particular – the City as a leading centre for legal services globally. For them, as well as for the UK economy as a whole, there is, therefore, value in their regulator recognising that it has a

role to play in promoting well run firms. Arguably, the Act could be more specific in requiring, or at least encouraging, regulatory support for the contribution made by the large firms to the UK economy.

10. With this in mind, we can outline the challenges for an appropriate new regulatory framework.

11. The language of the Act is ill-suited to the coherent alignment of the functions of the Legal Services Board ("LSB"), and both the representative and regulatory arms of each of the Approved Regulators. The statutory expectation that the functional independence of each regulatory arm can be adequately supported by the performance of its corresponding representative arm, and assured by the engagement of the LSB, has not wholly materialised. The systemic checks and balances seem to have become the weapons in what seems like a constant tussle about the transfer of resources from one arm to the other.

12. The primary task at the apex of any future regulatory pyramid will be to manage the new fault lines that will inevitably accompany any revision to the statutory functions of all those involved in the regulatory processes. This will provide the high level umbrella for the day-to-day regulators to get on with the practical tasks of regulating the various legal sectors. For solicitors, one model is to have say four or five semi autonomous divisions focusing on and providing appropriate types of regulation tailored to each different sector. The divisions would be semi autonomous in the sense that each division would be responsible for developing expertise in its own sector. Subject to arms length oversight and some cross-cutting standards, e.g. risk analysis techniques, each division would align its efforts to its sector's perceived risks and opportunities. For the City division, the quality of regulatory expertise could be a material factor in influencing the national and international market place. This model would need careful thought – we would not wish to unnecessarily increase the costs of regulation. Ultimately, a number of avenues might need to be explored, with the overall objective of increased regulatory efficiency leading to lower regulatory costs.

13. While we have no direct interest in other (non solicitor) sectors of the legal services market, we would have thought that similar divisions could also cover the bar, legal executives and others who currently have their own regulatory structures. Behind these divisions, there would be some opportunity to share best support practice, e.g. the balance between central and devolved administration and IT, accreditation issues, and practising certificates renewal processes.

14. We have no concluded view on a future structure for the LSB and the Approved Regulators. However, if the LSB continues to play an oversight role, we think it should rebalance its focus, giving equal weight to each of the eight regulatory objectives – supporting the rule of law, improving access to justice etc. – and be far more responsive to the concerns/interests of the regulated communities.

15. In conclusion, the current regulatory framework is dysfunctional and at some point will need to be overhauled once again. We are doubtful that the fundamental structural problems can be solved under the present Act. Given the extent of the task involved in

recasting the regime, and the number of stakeholders involved, we suggest that the initial steps are taken shortly. We would be happy to help further in that process.

David Hobart

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