



FOIL UPDATE

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The Hunt Review of the Regulation of Legal Services

Lord Hunt makes his final recommendations

Following almost a year of consultation and preparation Lord Hunt has published a very thorough, very readable, 109 page report on the Regulation of Legal Services. For Lord Hunt the professional values and ethics of the legal profession, and the commitment to put the client first, are paramount and the report's 88 recommendations are aimed at maintaining high standards within the profession, ensuring that the same standards apply to new entrants into the sector, and ensuring that the principles and structure of the regulatory regime work effectively according to regulatory best practice. Inevitably this is a high level report in which the recommendations often highlight issues and areas where Lord Hunt would wish to see the profession and/or the front-line regulator (the Law Society/SRA), and/or the oversight regulator (the LSB) work together to improve and develop regulatory practice. There are also a number of specific recommendations including for example a 'credit card' sized statement of Rule 1 to allow the abiding principles of the profession to be carried in a pocket, and a proposal for a new 'Hippocratic' oath for solicitors upon qualification.

The report begins with a review of the reports, recommendations and legislation which has brought the profession to its current position. Concerns expressed by the OFT and the DCA back in 2002 are noted, including concerns at the entry restriction caused by the prohibition on multi-disciplinary partnerships and the "regulatory maze" which practitioners faced.

The report looks back on the Clementi Report which, of course, led to the Legal Services Act, the creation of the Legal Services Board, and the splitting of the Law Society into two arms to create a professional body and a regulatory arm (the SRA).

The Condensed Read

High principles and ethics, and a commitment to the best interests of the client, are vital to the profession and must not be watered down by regulatory reforms.

The profession needs to take on board principles of good regulation: proportionality, accountability, consistency, transparency, and targeting. The SRA should also focus on the big picture: professionalism, a commitment to competition, maintenance of access to justice and a commitment to increased diversity within the profession.

Lord Hunt supports a move towards principle-based regulation, rather than detailed 'rules-based' regulation. He supports the concept of risk-based regulation to ensure that resources are focussed on areas which present the greatest risk. The Code of Conduct should be the corner-stone of the regime, with Rule 1 given superior status.

The separation between the regulatory and representative arms of the Law Society should continue, and the 'border skirmishes' between them should be resolved. The SRA needs to 'up its game' in a number of areas.

Lord Hunt proposes a new regime of self-regulation for firms, called Authorised Internal Regulation (AIR). All firms could aspire to be self-regulating, not just the largest.

The SRA should concern itself with the content of law degrees and the LPC. CPD should remain at 16 hours, with 8 hours to come from accredited courses. Non-solicitors may require CPD in future.

The creation of Alternative Business Structures (ABS) will create challenges – the legal landscape will never be the same again. A level playing field must be maintained with 'mainstream' firms. An ABS's PI insurance should cover all services it offers not just the legal or solicitor services.

Professional Regulation

As a starting point Lord Hunt reiterates the five principles of good regulation established by the Better Regulation Task Force (BRTF), now the Better Regulation Executive, (the body set up by the Government to provide an independent source of advice on regulation). These are: proportionality, accountability, consistency, transparency, and targeting. He highlights the importance of a cost-benefit analysis in quantifying the benefits of regulatory intervention, and the need for regulators to minimise any overlap between UK legislation and EU provisions. He notes that there is relatively little 'top-up' regulation emanating from the EU but EU Directives, such as that on distance selling, do have an impact. The profession is also open to scrutiny by the OFT and the Competition Commission.

Lord Hunt notes that traditionally there has been a strong focus on *ex ante* regulation – with prescriptive rules about entry, behaviour and continuing education. He looks at what it means to be a profession, noting that whilst anyone can behave professionally that does not make what they do a profession. He highlights a number of criteria that mark out a profession:

- Control by a governing body
- Required standards of education
- The existence of ethical rules and standards
- A focus on benefit to the public rather than the members of the profession
- The possibility of disciplinary action or expulsion
- Work reserved to the profession by statute
- Fair and open competition in the practice of the profession
- Independence of members in thought and outlook
- The offering of leadership to the public the profession serves.

Although research has shown that 83% of the general public who used a solicitor over the past five years were satisfied with their performance, around 15,000 people a year feel strongly enough to complain to the Legal Complaints Service. In fact, few legal activities are reserved and in general people go to a solicitor, not because they have to, but because they trust them. Although commoditisation of services is accelerating that does not mean that ethical standards can be compromised. In a more open market including Alternative Business Structures (ABS) solicitors will have to justify the high level service they want to provide and Lord Hunt believes that it is "ingrained integrity and ethical beliefs" which unite the profession: solicitors should "vigorously reassert their professional standards".

He recommends that the Law Society and the LSB (with others) should lead a wide ranging debate on what legal professionalism means in the modern world and how best to consolidate public trust, which could steer SRA policy in the future.

He recommends that the SRA should:

- Produce a clear statement of its policy to encourage competition.
- Always prefer the encouragement of better consumer information and consumer empowerment over formal rule-making
- Produce criteria to assess and measure access to justice.
- Continue to develop its work on increasing diversity within the profession.

Principle-based and risk-based regulation

Principle-based regulation means focussing on high level 'principles' rather than on detailed rules. This approach focuses on the purpose behind the rules. It avoids a 'tick-box' approach and removes any concept of 'loopholes' which can be exploited. It allows flexibility to avoid stifling market innovation. Lord Hunt emphasises that this is

not 'soft' regulation. It focuses on senior management responsibilities, as under principle-based regulation they carry responsibility for interpreting and applying rules devolved to firms and practitioners.

Lord Hunt recognises that principle-based regulation has taken a battering during the economic downturn but he feels that the problems encountered, particularly by the FSA, are not the result of the regulations but of too many firms ignoring them. There are lessons to be learned. Lord Hunt recommends that the SRA should produce and promulgate a clear exposition of how it intends to implement and continue to develop principles-based regulation.

Problems can arise with principle-based regulation: there can be a lack of certainty, an abundance of guidance can begin to be regarded as 'rules', and it can be seen as 'light-touch' when the opposite is true. Regulators need to be aware of these pitfalls and respond to them. Firms regulated in this way acquire new responsibilities and face new challenges. Firms must ensure consistency of interpretation across the organisation and Lord Hunt feels it would be helpful for a firm to record its rules and decisions. Different compliance methods within different firms are acceptable as long as there is a transparent decision-making process.

There is much talk of risk-based regulation: in Lord Hunt's view a concept difficult to pin down. The aim is to measure the risk of certain individuals and entities failing to deliver on their regulatory requirements, a consideration which then allows the targeting of regulatory resources proportionately and consistently.

Lord Hunt recommends that each firm should be encouraged to produce a calculation of the risk associated with its business, compliance arrangements and internal governance, which it should share with the SRA.

At present solicitors have a bewildering array of regulation, rules and practice guides to consider. Lord Hunt makes it clear that in his view the Code of Conduct should be the corner-stone, with everything else viewed as secondary. In addition, Rule 1 (which sets out the core duties of justice and the rule of law, integrity, independence, the best interests of the client, standards of service and public confidence) should be given "superior status" within the rules. Rule 1 should enable a solicitor to navigate his or her way through a situation regardless of whether detailed guidance on the point is given elsewhere in the rules.

Lord Hunt is not convinced that Rule 1 is drafted correctly at present: he recommends that the wording should be reassessed, and that, once finalised, if a legal practitioner can show that he or she has abided by the core duties there should be a strong presumption in their favour.

Lord Hunt then turns his attention to Rule 2, (the former Rule 15) which requires a client care letter to be sent at the outset. Many firms with business clients complain of the need to send these letters more frequently than the business relationship requires. At the moment a failure to send a letter to a repeat client would be a breach of the rules but, for Lord Hunt, the important point is the principle. He asks, if the bigger principle can be met by not sending a repeat client care letter what purpose is served by bringing a firm to book for breaching Rule 2 through failure to send one?

Lord Hunt recommends that the SRA should look carefully at Rule 2, using a principle-based approach, with a view to introducing a rule that is more flexible and more appropriate to the nature of repeat clients.

Accountability and Transparency

Lord Hunt believes that recent developments have gone some way to separating the regulatory arm of the Law Society (the SRA) from the representative arm, and to some extent, a 'corporate' Law Society has been created to manage all the functions of this complex institution. There is, however, still some way to go. He recommends the creation of a corporate board to oversee the services the two arms share, to resolve differences between them, and approve the budget.

The Law Society is currently establishing the Support Services Resolution Board (SSRB), a new joint body to resolve issues around shared services including premises, staff, salaries and benefits and it may be possible for this to develop into the corporate board Lord Hunt has in mind.

Lord Hunt outlines a number of recommendations for developing the SRA, including a obligation that it chart its progress against the criteria of good regulation; that it be as explicit as possible on the sanctions available to it and when it would use them; that it becomes a holder of the Plain English Campaign Crystal Mark within, say, three years; and that it sets up a separate function to consider complaints against it.

Proportionality

Lord Hunt calls for 'border skirmishes' between the two arms of the Law Society to be resolved. He sets out the three tasks of regulation: (a) setting the standards of admission; (b) setting and (c) monitoring standards of practice. With regard to (a) the two arms should work together.

The Legal Services Act sets out a dual approach, for regulation of both individuals and entities. The SRA can take direct regulatory action against an employee as well as the firm, if appropriate. The Legal Services Act requires that to do reserved legal work for the public both the individual and the firm must be authorised. It facilitates this by giving the SRA new powers, to control the setting up of new partnerships, impose conditions on firms and apply its rules to non-solicitor managers and employees. Solicitor firms already need to ensure that employees comply with the Code, and Lord Hunt believes firms should now ensure that all employees are familiar with the Code.

The new 'dual' regime, bringing together regulation of individuals and entities, leaves some issues to be clarified, such as exactly what falls within each type of regulation and how to manage gaps and duplication. It will still be appropriate to impose sanctions on individuals (for example, striking off for dishonesty) as well, or instead of, applying them to the firm.

Many respondents to the consultation complained that the SRA behaves disproportionately. Lawyers complain of inconsistency, heavy-handedness and delay. Lord Hunt recommends that the SRA should undertake rigorous impact assessments and cost-benefit analyses of all proposed rule changes; that in acquiring data it should adopt confidentiality requirements equivalent to those imposed on law firms; and it should make more use of consumer feedback.

Lord Hunt supports the proposals which the Better Regulation Task Force have put before Government to reduce the burden of regulation on business, the professions and the public sector. He hopes that "some future government will take a long, hard look at the regulatory burden across the board. It certainly needs to".

Two important technical issues are mentioned. Firstly, on the burden of proof, at the moment the SRA applies the civil standard and the Solicitors' Disciplinary Tribunal

applies the criminal burden. Lord Hunt calls for both bodies to consult and consider aligning standards of proof more closely.

He also recommends that the SRA enhance its guidance on its written and oral investigations of solicitors and consult with the profession on a Code of Conduct, along the lines of those which govern police investigations, to make the process fairer.

Targeting and Consistency

The move towards self-regulation

Lord Hunt begins this section with a consideration of the wisdom of targeting regulatory effort and looks at how the practicing certificate fee affects firms with a different make-up of qualified and unqualified staff. The fee is more expensive for firms with more qualified staff (although, in fact, that may make the firm less of a risk). Lord Hunt proposes that in future part of the fee should be allocated to the firm itself, in line with the move towards regulating entities.

Lord Hunt does not believe that firms with "sophisticated" corporate clients should be regulated any differently from other firms "If we go down the path of attempting to differentiate between firms on the basis of the clients they serve rather than the services they provide, we shall end up in a dangerous situation". He believes that the only distinctions between firms that are worth considering are the size and capacity of the firm and the extent of their compliance arrangements.

Lord Hunt says that a new system of regulation, to allow more self regulation, could take many forms but he favours a model that draws heavily upon Nick Smedley's proposals, following Smedley's review of the regulation of corporate firms. Lord Hunt's model would not just be open to City firms but also "other firms that can demonstrate their willingness and ability to set up internal governance standards that are robust enough to guarantee compliance". Firms would have to jump through a series of hoops to demonstrate that their governance and risk procedures were robust enough and contained sufficient checks and balances, such that the regulator would 'sub-contract' compliance monitoring to the firm. The senior controlling individuals in the firm would have to be suitable by virtue of experience, qualification, disciplinary record and general 'standing' for the management of such an enterprise. All rule breaches would be reported to the regulator and firms would have to certify to the regulator on a regular basis that the firm continued to comply. The 'entity' element of the SRA regulatory levy would be substantially reduced for self-regulating firms.

Not all firms could – or would want – to avail themselves of this approach but Lord Hunt emphatically does not regard it as the preserve of the larger/international firms. He would like to see it start at the top and become the aspiration of every firm. It will not be a 'light-touch' regime - there will be sanctions including heavy fines, censure, and bans from holding similar office. The system would be called AIR – Authorised Internal Regulation.

Whilst noting that the aim of the Legal Services Act was to clear away the "regulatory maze" Lord Hunt looks at the issues which arise with ABS, where more than one regulator may be involved.

In introducing the Legal Services Act Ministers anticipated that individuals would remain accountable to their own professional bodies and that day-to-day regulation of the practice would be handled by the entity regulator. Lord Hunt asks if this would render it acceptable for individuals engaged in reserved work to ignore parts of the Code of Conduct if the entity they worked for had a lighter regulatory regime? (a question he does not answer). Lord Hunt does not rule out completely the idea that

ABS could choose their regulator, if more than one regulated the services they provided. Existing regulators might apply to the Legal Services Board for authorisation to regulate a limited range of new activities undertaken by those they already regulate.

Many respondents to the consultation called for the extension of regulation to areas which are currently unregulated. He is "concerned about the grey area of regulation between the SRA and the team deals with Claims Management Companies, many of which offer non-reserved legal advice services". He recommends that the Claims Management regulator should come fully under the aegis of the LSB as soon as is practicable.

Lord Hunt makes a number of recommendations on the way the Solicitors Disciplinary Tribunal operates. He calls for the SDT to ensure that lessons are learned from its rulings, and, to that end, rulings and written findings should be published in full, and given more prominence in the press.

Lord Hunt would like to see the SRA more involved in 'prevention rather than cure'. He recommends that the advice given by the Practice Standards Unit (PSU) should be binding upon the SRA, and that any firm relying upon advice from the PSU should have a valid defence against charges of regulatory breach. The SRA should consider all Law Society Practice Notes in detail and comment publically on any issues with which it disagrees. The SRA should give guidance to the profession through e-mail updates and other direct communications.

Education and Training

In addition to the requirement to reach the required SRA standards Lord Hunt is attracted by the concept of a "Fellowship of the Law Society" award for those solicitors who have reached a significantly higher standard.

Although at the moment the SRA focuses on post-graduate issues Lord Hunt believes it should look at the content of law degrees He recommends that the SRA also consider re-instating monitoring visits for the LPC, to improve standards. He is concerned that too many people undertake the LPC who will not benefit from it and he calls for the SRA to encourage students to make a realistic assessment of their prospects of a career in law, before signing up for the LPC.

Lord Hunt identifies two recent trends: the rise in paralegals and the rise in volume of legal business which does not involve reserved work. Lord Hunt recommends that the SRA look at a proposal which would mean that authorisation to conduct reserved legal work would not be awarded automatically upon qualification, but instead each reserved area would be subject to separate authorisation, awarded after qualification.

Lord Hunt recommends that CPD should remain at 16 hours, but with 8 hours met through focused and accredited courses. He recommends that the SRA should consider a pilot scheme of CPD for non-solicitors working within regulated entities. Legal ethics should be introduced into legal education at the earliest opportunity and solicitors should be required to make a declaration similar to the Hippocratic Oath sworn by doctors.

Alternative Business Structures

In Lord Hunt's view the old partnership model has been withering on the vine for some time. Limited liability, succession and the tax treatment of corporate entities are all issues. ABS will allow lawyers to form multi-disciplinary practices offering legal and

non-legal services. Law firms will be able to seek external investment, sell shares and be partially or wholly managed by non-lawyers.

The Legal Services Board is determined that the first ABS licences will be created by mid-2011. Lord Hunt has nothing against that timetable but believes it is better to get it done right than get it done quickly. It is crucial that appropriate safeguards are put into place. For Lord Hunt an entirely separate regulatory regime for ABS does not seem practical. A practice which combines different services will be the trickiest to regulate, and, for example, the SRA may need to decide if the ABS should ring-fence the operation providing legal services, but, in essence, the ABS should be subject to the same regulatory requirements as other law firms. This will help maintain a level playing field and avoid the risk that firms will "go ABS" for regulatory rather than business reasons.

There are potential pitfalls ahead. Many existing rules for existing law firms will have to be re-examined in the light of ABS. For example, on referral fees, the SRA will have to take into account when drafting rules for ABS any changes to referral fees that emerge from the Jackson review. Lord Hunt asks: "Will the same rules be applied to ABS in such cases, or will existing rules for 'mainstream' firms have to be changed, to ensure a level playing field"?

Lord Hunt is still of the view that all ABS should be required to appoint a designated Head of Regulatory Affairs at board level or equivalent.

It is hard to judge the effect of ABS on access to justice. The regulator should be aware that an increase of access in one area may mean a diminution in another, for example services in rural areas may be affected by cheaper on-line services.

An effective 'fitness to own' test will be crucial to the credibility of ABS. One area that needs serious consideration involves institutions that already control access to some legal services seeking also to own a legal services provider. "Their interest may conflict with those of the consumer by bringing together preliminary advice and reserved legal services under one aegis". Another way of mitigating risk for clients of ABS firms is by ensuring that all services are backed by PI insurance. The SRA's preliminary view is that insurance is only required to cover "legal or solicitor services" but not services that are clearly not legal. Lord Hunt believes that insurance should cover all services provided.

Lord Hunt believes that the best way of ensuring that ethical and professional standards are maintained is by focusing upon the internal governance and compliance arrangements of ABS firms. He recommends that ABS firms should have to satisfy the governance and compliance criteria applied to law firms under the AIR regime and that they should be regulated according to similar principles.

The Hunt report is concluded with a short section entitled "A Great Future for a Great Profession". It indicates that perhaps the biggest question going forward is whether the SRA can strike a more positive note, "sharing with the world not only its policies towards breaches or potential breaches of regulations by bad lawyers or law firms, but also a clear and inspirational vision of how a good lawyer or law firm should look, organise its affairs and conduct itself". If Lord Hunt's report achieves nothing more than that the profession will have good reason to thank him.

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