



**Consumer  
Focus**  
Campaigning for a fair deal

# The regulatory regime for ABS – consultation response

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# Summary

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The main points in this submission are as follows:

- A mid-2011 start date for ABS licensing is both desirable and achievable. It is important that consumers have the opportunity to enjoy the benefits of ABS as soon as possible, subject to the risks being identified and managed. The LSB should be prepared to licence ABS directly in 2011 if necessary.
- We hope that greater competition facilitated by ABS will break down an apparently entrenched culture among lawyers that sees customer care as of secondary importance. Other potential benefits of ABS are improved access to justice, greater convenience from one-stop-shops, lower prices and improved service resulting from technological change funded by investors.
- Licensing authorities should adopt a risk-based approach to ABS, recognising that consumers will face much the same risks when buying legal services from licensed firms as they do when dealing with current providers.
- We support a regulatory approach based on high-level principles and outcomes, rather than one which sets prescriptive rules. This has the best chance of stimulating culture change because it forces senior managers in firms to take ownership of their responsibilities and actively think about what they need to do in order to achieve the desired regulatory outcomes.
- Access to justice is broader than the geographical availability of face-to-face legal advice and representation, but it is an important dimension of it. As a starting point, we suggest a definition of access to justice should include the impact on vulnerable consumers of issuing an ABS licence on the availability and affordability of legal advice or representation in areas of law where there is a significant public interest in ensuring its sustainable provision.
- Access to justice considerations should be capable of leading to a rejection of a licence application, but the burden of proof should lie with objectors. One practical solution is for a planning-permission style application system, where licensing authorities could impose licence conditions relating to access.
- Indemnification and compensation arrangements for ABS firms should be commensurate with arrangements in all other legal firms holding client monies.
- Not-for-profit bodies make an important contribution to access to justice, but the LSB's first consideration should be the level of risk they present. The regulatory framework should impose controls which are proportionate to these risks and no more. The Legal Services Commission's commissioning process might possibly be used as a proxy for licensing, but this idea requires further consideration.

# Answers to questions

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## Timeline

The Legal Services Board's (LSB) objective of a mid-2011 start date for ABS licensing is both desirable and achievable. The ABS provisions in the Legal Services Act hold the promise of tremendous benefits for consumers, so it is desirable for consumers to have the opportunity to enjoy these benefits as soon as possible, subject to the risks being identified and managed. The legal profession would also benefit from the speedy introduction of ABS, including through the availability of additional investment and the commercial potential of new business models.

The LSB can help to sustain the momentum towards this start date by articulating a compelling vision about the potential benefits of ABS. Progress will also be helped if consumer organisations are confident that the LSB has successfully identified and put in place safeguards to manage risks, and if potential licensing bodies are convinced that the requirements placed on them are proportionate.

We agree that the LSB should be prepared to license ABS directly in 2011 if necessary. Consumers should not be allowed to lose out from the ABS reforms due to a lack of enthusiasm or intransigence on the part of the legal profession.

Finally, we do not consider that the economic downturn is a reason to delay the introduction of ABS. We appreciate that the legal profession is facing reduced income streams, for example high-street solicitors will have less conveyancing work and consumers are cutting down on discretionary expenditure such as writing a will. However, a recession can be good for the economy in the long-term because it forces firms to innovate and improve their services in order to meet the demands of consumers. It is not the role of a regulator to protect inefficient firms from a fiercer competitive environment. Further, it might be argued that the anti-competitive restrictions that the ABS regime will remove is holding back the progress of firms that would like to innovate; law firms are already facing increasing competition from new entrants to the legal services market such as Halifax Legal Solutions and the AA.

## The benefits of opening up the market

Consumer organisations are no better placed than regulators to second-guess how the market for legal services will evolve to meet customer demand. Nevertheless, below we point to the benefits that opening up the market could yield for consumers.

Solicitors are the legal professional that consumers will come across most often. Most solicitors provide high quality advice and a decent standard of service to clients, but the caseload of the Legal Complaints Service and consumer research by the Solicitors Regulation Authority indicates that a significant minority do not. It is disappointing that causes of consumer dissatisfaction relate to problems that should be easy to fix, such as communication breakdown or delay. These problems are symptomatic of a lack of competition in the market as there is clearly an insufficient incentive for solicitors to provide first class standards of customer service. Yet good customer care is crucial in the legal services market as consumers use solicitors at times of emotional stress. It is our hope that greater competition in the legal services market facilitated by ABS will break down an apparently entrenched culture among lawyers that sees customer care as of secondary importance. The emergence of new entrants that already have daily contact

with customers, such as supermarkets or financial institutions, should stimulate solicitors to improve their performance in this respect.

Other potential benefits of ABS include greater convenience for consumers resulting from the combination of legal and other services in one-stop-shops. The availability of additional sources of investment could result in technological change able to transform the delivery of services such as conveyancing. The greater use of technology, together with fiercer competition between providers, should also exert downward pressure on price. Overall we believe that ABS will improve access to justice. Although there may be some risks to access to justice, which we consider later, the possibility of lower prices, a wider choice of providers (who can offer sophisticated telephony and longer opening hours) and an improved customer service ethos, should make legal services both more affordable and approachable in future.

## Managing the risks of opening the market

We agree that the role of regulators is to understand, reduce and manage risk in a way that minimises barriers to entry but provides sufficient protection for consumers. We agree too that, in the absence of a compelling case for further restriction, the differences between the ABS regime and that which bites on all sector participants should be minimal in number, evidence-based and restricted only to those set out in the Act. It is also our observation that consumers will face much the same risks when buying legal services from licensed firms as they do already when dealing with current providers.

Overall, we consider that many of the risks presented by sceptics of ABS are overstated and are not evidence-based. One example is the concern about lower standards because new entrants will focus on reducing price to the expense of quality. However, given the dominant position of incumbents, new entrants will be in for the long-haul rather than pursue a 'short-term profit and run' strategy. For companies with brands to protect, the potential damage to their reputation will act as a powerful brake on opportunism. Further, investors in ABS firms will also want assurance that the companies in which they have invested will pursue practices that are customer-focused and consistent with the rules.

Two key questions need to be answered: what regulatory approach is best suited to manage the risks of opening the market; and what are the particular risks related to ABS that require additional regulatory intervention. We consider these questions briefly below.

### Regulatory approach

We support a regulatory approach based on high-level principles and outcomes, rather than one which sets out prescriptive rules. Principles-based regulation did not cause the financial crisis, as was acknowledged in a recent report by the Regulatory Reform Select Committee<sup>1</sup>. We understand that small legal practices in particular will be attracted by the certainty afforded by a detailed set of rules. We can also see that specific rules are appealing to a profession that deals with the law. However, experience in other sectors suggests this route promotes a tick-box approach to compliance and encourages illegitimate companies to find loopholes in the rules, which the regulator is then obliged to close. A regulatory regime based on principles has the best chance of stimulating culture change – which we have identified as a need in the legal services sector – because it forces senior managers in firms to take ownership of their responsibilities and actively think about what they need to do in order to achieve the desired regulatory outcomes.

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<sup>1</sup> House of Commons Regulatory Reform Committee, *Themes and Trends in Regulatory Reform*, 2009.

The 'safe harbour guidance' approach put forward is initially attractive, but we would discourage the LSB from writing too much guidance as the default choice for most firms would be to pursue the tick-box approach described above.

## Access to justice

### Defining and evaluating access to justice

We agree that the concept of access to justice is broader than the geographical availability of face-to-face legal advice and representation. There are types of legal transaction, such as simple conveyancing, which are already commoditised and delivered remotely. However, face-to-face advice is an important dimension of consumers' ability to access justice. This is particularly true for certain groups of vulnerable consumer (eg the elderly, consumers with low literacy skills), in more complex areas of law where face-to-face advice would aid explanation, and in stressful situations where the human touch makes things more bearable to deal with.

Professor Stephen Mayson makes the distinction between access to justice (the ability to pursue a legal remedy or defend oneself against criminal charges or civil claims) and access to legal services (where legal services are desirable and a choice of the citizen, eg moving house)<sup>2</sup>. We acknowledge the difference between these concepts, but we do not believe that lawmakers had this distinction in mind when drafting the ABS provisions in the Legal Services Act. Further, we would question if some legal services falling into the second category, such as conveyancing, could truly be classified as optional. We consider that a broad definition of access to justice encompassing both of the elements above would meet better the spirit of the legislation.

Access to justice is an intangible concept that escapes easy definition; the LSB should consider this further in discussion with stakeholders. However, as a starting point we suggest a definition should include the impact on *vulnerable consumers* of issuing an ABS licence on the *availability* and *affordability* of legal advice or representation in areas of law where there is a significant *public interest* in ensuring its sustainable provision.

### Impact of ABS on access to justice

As stated earlier, overall we consider that the ABS reforms will improve access to justice. However, we do think there is a danger that new entrants will focus their efforts on those areas of law which are the most profitable, eg conveyancing. The risk is that new entrants will squeeze out local providers who use income from those same areas of law to subsidise more niche activities that serve a vital public benefit, such as immigration law or mental health law.

The Legal Services Act does not rank the regulatory objectives in any order of priority. However, the ABS provisions require licensing authorities to address how they will take account of the access to justice objective in connection with an application for a licence. In our view, access to justice is of such critical importance, that this provision alone should be capable of leading to the rejection of a licence application. However, the burden of proof should lie with those who object to a licence application.

How the application process will run in practical terms needs careful thinking through. There may be the opportunity to learn lessons from the planning process. In this scenario, a business wishing to apply for an ABS licence would have to advertise that they have submitted an application. The application process would include a time period for any party to lodge an objection on access to justice considerations with the relevant licensing authority. The licensing authority would be obliged to consider objections raised

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<sup>2</sup> The College of Law, *Discussion paper: External ownership and investment: Issues and Challenges*, 2008.

and could either approve, refuse or propose licence conditions. The licence conditions could involve steps that the applicant must take to safeguard access to justice, such as guaranteeing to provide specified types of legal service. There are parallels here with the supermarkets sector, where planning authorities may require a supermarket chain to build affordable housing in a local area as a condition of opening a new store.

### **Indemnification/compensation**

Indemnification and compensation arrangements for ABS firms should be commensurate with arrangements in all other legal firms holding client monies. We agree that, unless strong evidence emerges to the contrary, safeguard for consumers should come from protection for individual client monies rather than controls over the capital structure or adequacy of the entity.

The risk of ABS firms becoming insolvent is arguably harder to judge for regulators because they are likely to sell a wider range of products and services than traditional law firms. The current economic conditions make it even more salient for client monies to be adequately safeguarded. The Consumer White Paper<sup>3</sup> announced that the Government will reassess the regulatory framework for prepayments following a report from Consumer Focus. Our report, *Pay now, pay later*, was published on 7 August<sup>4</sup>.

### **Complaints-handling**

We agree that arrangements for complaints handling specified for ABS should not, unless there is strong evidence to the contrary, be materially different from those specified by regulators for the non-ABS environment. We would be very surprised if there was any such evidence. It is worth remembering that any complaints handling requirements that the LSB might prescribe in future will be minimum standards. In a competitive environment we would hope that new entrants would exceed these minimum standards.

### **Special bodies**

#### **Not-for-profit bodies and community interest companies**

We share the view that not-for-profit bodies and community interest companies make an important contribution to providing access to justice for vulnerable consumers. However, the LSB's first consideration in designing the regulatory framework should be the level of risk posed by providers of legal services. This framework should impose controls which are proportionate to these risks and no more. This is true for all regulated entities.

As the consultation document highlights, such bodies conceivably present a higher risk in some respects and a lower risk in other respects. On the one hand, the risk of conflict of interests is low in the absence of commercial motives. On the other hand, variable governance, variable performance between highly localised units, and the vulnerable nature of the client group, present higher-risk factors. The potential for local variability in performance makes us nervous about a 'group licensing' approach.

We would encourage the LSB to consider further if the Legal Services Commission's commissioning process could be used as a proxy for licensing. In this case, the LSB would need to be satisfied that the risks that licensing authorities and the LSC are seeking to manage are broadly compatible. We do not have sufficient expertise in this area to offer a view as to whether this is currently the case.

We do not offer views at this stage on trade unions, low-risk bodies and LDPs.

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<sup>3</sup> HM Government, *A Better Deal for Consumers*, July 2009, Ch3, p59.

<sup>4</sup> Consumer Focus, *Pay now, pay later: Consumer prepayments and how to protect them*, 2009.