

## Investigation into the cost of regulation in the market for legal services in England and Wales: scope of project

1. The hypothesis that regulation of legal services in England and Wales is too costly is regularly put forward by different stakeholders in the market<sup>1</sup>. Our aim with this project is to:
  - investigate the drivers of costs
  - gather evidence:
    - to allow a more informed debate
    - for policy makers and regulators to base future work on.
2. The scope of this project is necessarily broad. However, in order to keep the project manageable, clear demarcation of the work to be undertaken is needed. This is also necessary to adhere to the project timetable and in particular our commitments in the [business plan](#)<sup>2</sup>.
3. This project will have two strands. The first will investigate the costs of regulation faced by legal services providers. The second will explore the costs of the regulators and the LSB.

### Project strand 1: costs on businesses

4. To determine the scope of this strand of the project we begin with a few starting principles:
  - We will look at the cost of regulation, where regulation comprises the rules that govern authorisation as an authorised person<sup>3</sup>
  - Only costs that are compulsory for authorised persons will be in scope
  - Only costs that are imposed by approved regulators under the Act will be in scope
  - Costs that are borne voluntarily for commercial benefit will not be within scope
5. For example:
  - **Criminal Litigation Accreditation [Scheme](#)**
    - voluntary cost assumed by providers to qualify to apply for inclusion on local duty solicitor rotas

Therefore: the cost is outside scope.
  - **‘Permitted purposes’ ([section 51 of the Act](#))**
    - involuntary cost that solicitors, barristers and legal executives are required to bear as part of their practising certificate fees

Therefore: the cost is within scope.

<sup>1</sup> For example by the [Law Society](#); the [Bar Standards Board](#); the [City of London Law Society](#); and the [Bar Council](#).

<sup>2</sup> The business plan allows for a very broad scope to this project (at p19-20): “In 2014/15 we will examine the various components of regulation that place a burden on the legal sector in order to identify potential cost reduction and simplification measures... The ultimate objective is to produce a set of recommendations for reducing the overall cost of regulation, which can be implemented across the regulatory community in the future.”

<sup>3</sup> We use ‘authorised person’ here as it is interpreted in section 18 of the Act- to cover both individuals and entities

- **Conveyancing Quality [Scheme](#)**
    - voluntary cost assumed by providers to qualify to apply for inclusion on various lenders' conveyancing panels

Therefore: the cost is outside scope.
  - **Exiting the market (eg successor practice rules, runoff professional indemnity insurance)**
    - involuntary costs that are imposed by regulators

Therefore: these costs are within scope.
6. Decker and Yarrow have [explained](#) that within what they call the “rule-books... governing social and/or economic interactions/transactions in a particular area of economic activity” fall both formal sector specific rules, and also custom and practice. We acknowledge that both of the example accreditation schemes in the list above impose costs on firms. A solicitor may feel compelled to join the Law Society’s Conveyancing Quality Scheme if s/he wishes to offer conveyancing services. However, as a voluntary cost assumed for commercial benefit, for the sake of this project we do not consider accreditation schemes to be a cost of regulation. They are part of the custom and practice that has grown up around the framework of the Act. A cost has to flow from a regulatory requirement to be within scope of this project. Even if providers feel compelled to accredit in some way, if that compulsion does not come from a legal services regulator the cost will be outside of scope. Similarly, if the cost being incurred is not necessary to be an authorised person, it will be out of scope.
7. We will consider one-off as well as ongoing regulatory costs. We will also include both compulsory direct and indirect costs. Direct costs manifest as fees paid by providers to the regulators (eg practising certificate fees). By indirect costs, we refer to the costs of complying with regulation. These are most commonly seen through costs to business from employing people to ensure compliance with regulation, whether entirely or as part of their work. Indirect costs arise because time spent by staff on complying with regulation, for example providing information to a regulator, is time not spent earning money for their employer. There could additionally be broader systems and opportunity costs for staff in firms beyond those with direct regulatory responsibility.
8. This project will be informed in part by Kyla Malcolm’s [work](#) on the proportionality of legal services regulation. We note Kyla’s conclusion that while the burden imposed by individual regulatory requirements may look reasonable in isolation, it is necessary to look at the combined regulatory costs faced by businesses in order to properly assess their impact. We have also borne in mind our 2010 regulatory information [review](#), which looked for other research on the cost of regulation in legal services and found very little.

### Types of regulatory cost

9. To aid discussion we have divided the costs that are within scope of this strand of the project into four categories:
- i. *Entry costs*
    - One off costs of entering the market eg licensing as an ABS

- ii. *Mobility and expansion costs*<sup>4</sup>
  - For example, adaptation costs incurred when moving into a new area of practice
- iii. *Compliance costs*
  - Everything a firm has to do to comply with sector specific regulation eg compulsory professional indemnity insurance
  - Annual financial costs imposed by approved regulators on providers eg practising certificate fees (including compulsory representative body fees)
  - This category includes only additive costs ie additional costs that regulation imposes beyond what is simply good business practice
  - This category also encompasses the time costs of regulation (ie time spent on compliance and not on earning fees from clients), and the opportunity costs (where the opportunity cost of a choice is the value of the best alternative forgone)
- iv. *Exit costs*
  - Cost of exiting the market eg successor practice rules, runoff professional indemnity insurance<sup>5</sup>

### Education and training

10. We will not be considering the cost of qualifying as an authorised person. Since the Legal Education and Training [Review](#) only relatively recently concluded, we do not intend that this project explore or make recommendations in an area where some regulators are still reviewing their arrangements. However, ongoing costs of training from the point of qualification onwards will be within scope.

### Continuing professional development (CPD)

11. We are including training requirements from the point of authorisation onwards within the scope of this project. Traditionally CPD for authorised persons has centred on the requirement to undertake a set number of hours of training per year. As this is a cost imposed by regulators, over and above that of simply ensuring that individuals are competent to deliver legal services, we intend to include the cost of this type of CPD requirement within the scope of this project. We note the SRA's intention to move to an outcomes focused approach to ensuring solicitors remain competent throughout their career, and to remove their 16 hour per year set training requirement. The question of what constitutes efficient expenditure in meeting CPD requirements is one that will be addressed in partnership with our external consultants (see below under 'questions regarding scope').

### Costs resulting from the regulatory framework

12. In this strand of the project, the project team will consider costs created by the Act's regulatory framework but only so far as:

- The framework is a driver for other costs eg the existence of the LSB and LeO results in a levy that is imposed on the profession as part of their practising certificate fee

<sup>4</sup> Firms have a variety of choices about how they expand, but some choices will incur additional regulatory costs which are in scope.

<sup>5</sup> We recognise the difficulties inherent in attempting to collect data relating to exit costs, but intend for the external researchers to consider this area

- Demands from the LSB or LeO place direct compliance costs on firms eg LSB's diversity monitoring requirements, or LeO's information requests
- Demands from the LSB place compliance costs on the regulators, which eventually filter down to firms through practising certificate fees eg amendments to the [Internal Governance Rules](#) that required changes to the appointments and reappointments processes for the regulatory boards.

13. The project will not consider other costs imposed by the existing regulatory framework. For example, the existence of other legislation in conjunction with the Act (such as the Solicitors Act 1974) creates costs through the need for section 69 orders. These costs will be out of scope. This strand of the project will therefore not consider possible savings that could be made by the introduction of a single legal services regulator.
14. We believe that the costs identified in the preceding paragraph can be characterised as arising from an imperfect statutory framework for legal services in England and Wales. These costs are relevant to the LSB's simplification work, and therefore are outside the scope of this project. This project will help inform any future work on costs imposed by the complexity of the regulatory framework, and would be a vital part of the foundation for that work. The second strand of this project will explore the costs of the regulators and the LSB and consider whether there may be any areas of concern.

### Other regulatory regimes

15. Only costs imposed by regulators set out in the Act will be within scope. Costs resulting from other regulatory regimes, for example the cost of accreditation or exemption by the Office of the Immigration Services Commissioner under the Immigration and Asylum Act 1999, are outside of scope of this project.

### Benefit of regulation

16. This project will consider solely the cost of regulation and not the benefit. However, we recognise the close connection between the cost of regulation and its potential benefits, and intend to consider benefits in subsequent work. This project will lay the foundation for that later work by potentially identifying certain areas of regulation that are driving high costs for providers. This would frame our work on benefits by highlighting different regulations that could usefully be looked at.

### Implementation of any recommendations

17. Our ultimate objective is to produce a set of recommendations for reducing unnecessary regulatory burdens in the legal services market. Implementing these recommendations is outside the scope of this project.

### Business plan commitments

18. The LSB's 2014/15 [business plan](#) states that the cost of regulation project will focus on the following four areas:

- *Direct regulatory costs imposed on regulated individuals and businesses*

This would include only involuntary costs, not those taken on voluntarily in order to gain some commercial benefit.

- *Costs imposed by the regulatory framework, including the LSB and Legal Ombudsman*

As discussed above, this would only be included in the first strand of this project where the existing framework is a driver for other costs. The costs of the regulators, and how these are determined and controlled, will be considered in the project’s second strand.

- *Indirect regulatory costs faced by regulated individuals and businesses in complying with legal services regulation*

Direct regulatory costs involve a fee being paid to a regulator. By indirect costs we mean those where no direct fee is involved eg complying with diversity requirements.

- *Regulatory burdens imposed by professional bodies on regulated individuals and businesses*

This encompasses the Act’s permitted purposes, where professional bodies such as the Law Society, Bar Council and Chartered Institute of Legal Executives still require compulsory payment from the providers they authorise for certain functions.

**Summary table of examples for first strand of project**

In scope	Out of scope
Involuntary costs of compliance	Discretionary costs of compliance
Compulsory training post qualification e.g. CPD	Education and training required to qualify as an authorised person
Exiting the market	Voluntary training
Complying with LeO requests e.g. providing information	Voluntary accreditation
Complying with LSB requests e.g. diversity monitoring	Other compliance costs e.g. Land Registry requirements
Practising certificate fees (including levies and compulsory representative body fees)	Voluntary cost of representative functions of approved regulators
ABS licensing fees	Costs imposed by regulatory regimes other than that of the Act
Recognised body fees	Implementation of any recommendations
	Benefits of regulation
	Unregulated sector

**Questions regarding scope**

19. With the aid of the economist and legal market expert the following issues need to be addressed:

- **Inefficient expenditure complying with regulation**
  - For certain regulatory requirements providers can choose how much they spend on compliance, such as deciding whether to place a senior associate or a partner in the role of compliance officer for legal practice or compliance officer for finance and administration<sup>6</sup>
  - How can we determine the level of expenditure that goes beyond what is necessary for compliance?

<sup>6</sup> Rule 8 of the SRA’s authorisation rules states that compliance officers must be of sufficient seniority and in a position of sufficient responsibility to fulfil the role

- A related, but slightly different, point is how we capture different levels of expenditure in complying with regulation which is not inefficient of itself, but results from the fact that entities might be interpreting what it means to be 'compliant' in different ways. This is of particular relevance given the shift to OFR by some approved regulators
- **Individual and entity regulation**
  - The regulation of individuals and the regulation of entities do not dovetail perfectly, which could lead to some duplication of costs. Would the requirement to consider both individual and entity regulation therefore disadvantage regulators that also regulate entities?
  - Would it be possible for these regulators to separate out the costs of individual and entity regulation?
- **Different regulated areas**
  - How can the fact that the project allows for some degree of comparison across ARs and regulated areas best be exploited? In particular, some thought needs to be given to how the data is collected across different regulated areas – for example, through the use of common categories of regulatory costs for solicitors, barristers, legal executives etc. This categorisation can potentially build on the work detailed in Annex 1

## Project strand 2: costs of the regulators

20. In this strand of the project we will undertake a high level exploration of the spending of the LSB and the approved regulators. This will include a review of practising certificate fee expenditure. We will work with our statutory decisions team (who are in charge of approving the level of [practising fees](#)) to determine what analysis is possible using existing available data (see project document 2: proposed research approaches for more information).
21. We will use an external cost accountant to determine suitable benchmarks for each of the bodies being looked at. These are yet to be determined, but could include other regulated sectors, international experience, or benchmarks from the public or private sector. From comparisons between the data gathered and these benchmarks, we identify whether we or any of the regulators are outliers in any particular areas (for example, percentage of income spent on overheads). We will compile as full a set of data about each of these bodies as is reasonably possible, or will determine reasons why the information cannot be found. This work will provide comments for each body outlining what the exercise has shown.

## Future work

22. We envisage that this will be the first in a series of projects. We consider this stage to broadly be about information gathering and gauging firms' perceptions of the cost of regulation and the drivers of those costs, as well as developing a better understanding of the costs of the regulators themselves (see project document 2: proposed research approaches for more information). A potential next stage would look in more detail at the causes of those costs and at the benefits of regulation, with the ultimate aim of recommending where unnecessary regulatory burdens can be removed. This thinking will be developed further as this project develops.