

To:	Board
Date of Meeting:	28 April 2011
Item:	Paper (11) 32

Title:	Smaller Approved Regulators research – LSB reaction
Workstream(s):	Developing regulatory excellence
Introduced by:	Crispin Passmore, Director of Strategy crispin.passmore@legalservicesboard.org.uk / 020 7271 0086
Author:	James Meyrick, Regulatory Project Manager james.meyrick@legalservicesboard.org.uk / 020 7271 0083
Status:	Protect

Summary:

This paper proposes that regulation should deliver the following outcome: a legal services market in which all Authorised Persons are regulated in an efficient manner which reflects best regulatory practice; that all consumers are protected from unacceptable risks; and that the Approved Regulators (**AR**) promote the regulatory objectives.

The research into the smaller ARs suggests that few of them are currently achieving the outcome or are carrying out activity that could be reasonably expected to achieve the outcome. Most would also have difficulty further enhancing their regulatory resources to be able to meet this outcome. Planned LSB work will further investigate and test the ARs' ability to deliver the outcome and other requirements of Legal Services Act 2007 (**the Act**).

Our proposal is to detail the outcome we are trying to achieve, the sort of features a system to deliver the outcome would have (derived primarily from the developing regulatory standards work) and then challenge the smaller ARs to consider the implications of the research and how they can deliver the outcome. The LSB should then act as a critical and sceptical friend of the ARs. We should continue to be helpful to the ARs, and open to be convinced by their proposed policy responses. But if no (or not enough) movement by the ARs is discerned we should not be afraid of using our powers.

To do this we will provide them with advance copies of our research and the initial LSB view (as articulated in this paper). We should also hold a dinner for the smaller ARs to introduce our thoughts and allow the ARs to discuss the matter. The research and this paper will then be published – approximately four to six weeks after being provided to the ARs.

Risks and mitigations

Financial:	N/A.
FoIA:	Exempt – s22. The paper will be released following the publication of the smaller ARs research, which is scheduled for June 2011.
Legal:	Our vires for conducting this work may be challenged by the ARs within scope. However, by ensuring that our actions, in particular those concentrating on an outcome drawn from the Act's requirements, can be tied back to our s4 duties in relation to

	promoting regulatory standards, then this risk should be mitigated.
Reputational:	<p>The research and Board paper contains a number of criticisms of the ARs within scope. The publication of these criticisms may damage existing relationships and attract negative press comment. They may also attract questions about previous LSB decisions in relation to these ARs.</p> <p>To counter this, we intend to provide the ARs with the research well in advance of publication and carefully explain our thinking to them. In addition, we will ensure that we have a detailed media briefing in order to clarify our position, the documents and our next steps.</p>
Resource:	If the ARs within scope reject the findings of the work or choose not to address their regulatory shortcomings, the LSB is likely to be required to work intensively with the ARs and possibly ultimately have to take enforcement action. This is likely to be resource intensive for the LSB.

Consultation	Yes	No	Who / why?
Board Members:		✓	
Consumer Panel:		✓	
Others:	N/A.		

Recommendation(s):
<p>The Board is invited to approve:</p> <p>(a) the publication of the smaller ARs research (Annex B) in June</p> <p>(b) the desired policy outcome, the actions detailed in the paper below to encourage the smaller ARs to meet this policy outcome and respond to the research, and the proposed approach to handling.</p>

LEGAL SERVICES BOARD

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Smaller Approved Regulators research – LSB reaction

Recommendation

The Board is invited to approve:

- (a) the publication of the smaller ARs research (**Annex B**) in June
- (b) the desired policy outcome, the actions detailed in the paper below to encourage the smaller ARs to meet this policy outcome and respond to the research, and the proposed approach to handling.

Desired policy outcome

1. A legal services market in which all Authorised Persons are regulated in an efficient manner which reflects best regulatory practice; that all consumers are protected from unacceptable risks; and that the Approved Regulators (**AR**) promote the regulatory objectives.

Policy review

2. In order to achieve the desired policy outcome, we need to ensure: that all ARs are regulating in a manner that is consistent with best regulatory practice; that they understand the risks faced by consumers in their markets and are proactive to reduce them; and that they have programmes in place to promote the regulatory objectives. The research shows that most of the smaller ARs cannot currently be said to be carrying out the sort of activities to deliver the desired policy outcome. The research also casts doubt on whether some of the ARs have the resources or inclination to make the investment necessary to achieve that outcome.
3. In addition, the LSB has a series of ongoing and forthcoming initiatives that are likely to further test/investigate the smaller ARs', and indeed all ARs', ability to deliver the desired policy outcome. The 'Developing Regulatory Standards' work will require them to examine critically their current regulatory arrangements against best regulatory practice and, if they are deficient, produce action plans as to how they are going to meet these requirements. In the coming months and years, all ARs will also have to address the challenges of entity regulation, outcomes focused regulation and ensuring that the consumer interest is reflected in their activities and rule change applications. Other LSB initiatives to promote the regulatory objectives – such as complaints handling, QAA, diversity and education and workforce development – will require engagement and resources from the ARs. Finally, the individual ambitions of some of the smaller ARs, in particular to broaden the range of activities that they currently regulate, may introduce higher regulatory risks and so there will be higher resource requirements for those ARs as they will need to invest in new systems, processes and staff. The LSB will be proportionate in our requirements from the smaller

ARs. However, this is not the same as an exemption; and Legal Services Act 2007 (**the Act**) applies equally to all ARs.

4. The confluence of the Act's requirements and other initiatives is likely to severely test the smaller ARs and they will be faced with difficult choices if they wish to deliver the desired policy outcome. This is because the smaller ARs are likely to need to increase the level (in terms of both volume and capability) of regulatory resources available to them. To do so, they could increase the size of their market (and so their revenue); increase the amount of funding provided to their regulatory arm (either through increased practicing fees and/or reduced spending on representation activities); reduce the scope of their regulation and/or ambitions (and so reducing regulatory risk and the resources needed to mitigate those risks); or seek economies of scale through collaboration or consolidation. The options are not mutually exclusive but they are also not 'pain free' and it could be said that some of the options are simply either unfeasible or too unattractive for the smaller ARs.
5. If the smaller ARs decide not to address the issues detailed in the research and adopt a position of non-compliance / minimal compliance with the Act and other LSB initiatives, then the LSB will be faced with the possibility of immediately entering into a resource intensive exercise (for both sides) that is likely to end in enforcement. Alternatively, if the smaller ARs decide to try and achieve the policy outcome without extending their resource base, reducing their ambitions / scope of regulation or developing economies of scale, then there is a risk of failure over the long-term. However, over the short- and medium-term, the process of working with those smaller ARs is likely to be disproportionately resource intensive for the LSB; bearing in mind the relatively low level of consumer risk highlighted in the report and potentially fractious throughout – the 'do-nothing' option is anything but!
6. This suggests that the ideal approach for an AR is to take on board the criticisms of the research, address them, and decide on a policy that will enable them to meet the challenge of delivering the desired policy outcome. The LSB's role in this process is to act as a critical and sceptical friend of the ARs. We should continue to be helpful to the ARs and open to be convinced by their proposed policy responses. But if no movement or not enough movement by the ARs is discerned we should not be afraid of using the full suite of our powers.
7. This means that the LSB's immediate role is to facilitate discussion and enable the ARs to consider the implications of the research, and how they can respond to the likely future challenges. To do so, we should provide them with advance copies of our research and the initial LSB view (as articulated in this paper). We should also hold a dinner for the smaller ARs to introduce our thoughts and allow the ARs to discuss the matters amongst themselves.
8. The research and this paper will then be published – approximately four to six weeks after being provided to the ARs. This pause will allow the ARs the opportunity to offer a full and considered response to any enquiries from their members or the press when the work is published.

9. This work has strong links not only to the 'Developing Regulatory Standards' work considered by the Board, but also the reserved/unreserved work.
10. **Annex A** provides a short summary of some of the key issues identified by the research for each smaller AR.

LSB actions

11. The LSB should provide this paper and the research to the smaller ARs within the scope of the research. They should then be asked to attend a dinner to discuss the findings and hear the LSB's views directly. The research and this paper will then be published a month or so after this dinner. The LSB will not seek an immediate formal response from the smaller ARs regarding the research; however, we would appreciate an indication as to how they intend to react to findings of the research in the course of the summer.
12. If some or all of the ARs involved do decide to investigate the possibility of some level of collaboration or cooperation, then the LSB would support such an initiative and provide guidance where necessary. We will not dictate to them the structures or processes that must be adopted, but merely restate the policy outcome we desire and suggest what features – as detailed in our developing regulatory standards work – we would expect any proposal to have. If desired, we could offer more general logistical support such as meeting space or even the work of an 'honest broker.'
13. The LSB will review whether the research concerns are being appropriately addressed by the end of 2011. This will be closely tied to the proposed developing regulatory standards assessment. In both cases, this will enable plans to be specified in the business plan for 2012/13.

ANNEX A – SUMMARY OF AR SPECIFIC RESEARCH FINDINGS

1. Below is a short summary of some of the key issues identified by the research for each smaller AR.

Association of Costs Lawyers (ACL) / Costs Lawyer Standards Board (CLSB)

2. The CLSB is the newest regulator and LSB has previously accepted that it could have some time to establish the necessary processes and arrangements to regulate its individuals; the outcome of this is that it is currently not fully compliant with the Internal Governance Rules or the complaints handling and signposting rules. The main ongoing issue for the ACL/CLSB is the lack of resources and its inability to raise revenue through higher practicing fees. It is claimed that this inability arises due to the fact that much of the services offered by Costs Lawyers are not reserved activities; so individuals can simply choose not to offer these services and so not pay the practicing fee.
3. A major future issue for the CLSB is whether it needs to apply to become a Licensing Authority (LA). The CLSB does not know how many of its individuals work or own firms that would be classed as an alternative business structure (ABS) once the transitional period ends, but it is suspected that a number will. Any application will require significant investment.
4. In order to generate greater resources for regulation in the future, the CLSB believes that it will be able to attract new Costs Lawyers as it develops credibility and the new legal services market beds down. This certainly appears possible in the medium-term and it has already expanded the number of Authorised Persons it regulates, although this is against a background of costs reform which may reduce the work available to Costs Lawyers. In addition, the ACL hopes to lobby for the creation of a reserved activity in the area of costs, or some sort of protection of title, the creation of which will incentivise unregulated costs practitioners to become Costs Lawyers. This ambition, while possible, is speculative and unlikely to occur in the short- to medium-term.

Chartered Institute of Patent Attorneys (CIPA) / Institute of Trade Mark Attorneys (ITMA) / Intellectual Property Regulation Board (IPReg)

5. The regulator, IPReg, has developed its regulatory structure quickly and its governance structures are compliant with our rules. However, similar to the ACL/CLSB, there is a lack of resources at IPReg – although the ARs do have greater resources performing representative roles than the ACL. IPReg is working hard to develop appropriate systems to monitor and regulate its authorised persons. However, at present, it holds little information about its regulated community and the risks to consumers.
6. The main services offered by CIPA and ITMA members are not reserved activities. Therefore they feel unable to raise practicing fees significantly to increase their regulatory resource base. This is because practitioners may simply choose not to offer reserved services if the fees went too high, and so will not pay the fee or remain regulated by IPReg further eroding IPReg's resource base.

7. They also have to make a choice as to whether to become an LA. They know that a number of the entities they regulate are ABS-type firms; so when the transitional period is lifted, IPReg will either have to be an LA or these firms will have to find a different regulator or change their business structures. Becoming an LA will require significant resources and not becoming one could have a significant impact on their revenue and sustainability – this makes the choice particularly difficult.

Council for Licensed Conveyancers (CLC)

8. The CLC was deemed by Nick Smedley as the most complete of the ARs within the scope of the research; although this is not without caveats. For example, he pointed out that it is only recently developing a more risk-based approach to its regulation. However, the research suggested that the main issue for the CLC arises around its ambitions.
9. CLC currently successfully regulates ABS-type entities which provide conveyancing and probate services. A small number of large ABS-type entities provide the CLC with a significant portion of its revenue. In order to continue to regulate these entities, the CLC has recently applied to become an LA. Failure to grant this application might result in the ABS-type firms currently regulated having to find a new regulator when the transitional period ends. If these firms left the CLC, then they may struggle to continue the high level of regulation they currently carry out. In addition, if the SRA is also granted LA status, a number of the ABS-type entities may choose to be regulated by the SRA so that they can offer a broader range of reserved legal activities.
10. Partly to counteract this risk, the CLC wishes to apply for designation to regulate the reserved legal activities of the conduct of litigation and rights of audience. If successful, it will be entering areas with different risks and different regulatory challenges. It remains to be seen whether the CLC will have the resources to deliver an appropriate regulatory regime to mitigate these different risks.

Faculty Office

11. The Faculty Office is the oldest AR in the scope of this work and it is the only one with an exclusive jurisdiction – as it is the only body allowed to regulate notarial activities. It is also able to regulate conveyancing, probate and the commissioning of oaths. The research suggests that its approach to regulation is old fashioned and is opposed to the reforms. Like the other smallest of ARs they have limited human resources, carry out little monitoring work and know little about the consumers of the services offered by their regulated community.
12. The research suggests that the risks to consumers from purchasing notarial services appear to be relatively low. You could conclude that this is because the most important aspect of notarial work is that the notarial act is accepted internationally. However, the small number of notaries conducting probate and conveyancing with only limited supervision from the Faculty Office do pose a risk to consumers. Therefore the most pressing challenge for the Faculty Office is for them to determine whether these arrangements are acceptable.

Institute of Legal Executives (ILEX) / ILEX Professional Standards (IPS)

13. In terms of revenue and membership, ILEX is the largest AR within the scope of this work – with 7,800 Authorised Persons. IPS does have more data on its Authorised Persons than other smaller ARs and it has established arrangements for complaints, investigations and discipline. However, it does not apply any true risk assessments of its Authorised Persons or their consumers. It does not have a developed programme of monitoring and lacks data on the consumers of the services offered by Authorised Persons. However, as the vast majority of their Authorised Persons work under the supervision of solicitors regulated by the SRA, there is a lower risk from these omissions.
14. Like the CLC, ILEX is an ambitious AR. It is currently seeking extended rights in the area of probate and wishes to allow its wider membership to conduct litigation and exercise a rights of audience independently under their regulatory oversight (only Associate Prosecutors working for the Crown Prosecution Service can currently conduct litigation under the regulatory supervision of IPS and individuals may not exercise rights of audience independently). In addition to these applications and rule changes, it has longer term ambitions to become an LA and regulate conveyancing. To achieve these ambitions, the research suggests that IPS would have to have more resources to develop more sophisticated regulatory systems and processes.