

To:	Board
Date of Meeting:	12 October 2011
Item:	Paper (11) 67

Title:	Developing regulatory standards – progress report
Workstream(s):	Developing regulatory standards
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Status:	Protect

Summary:

In May, LSB published the consultation paper, 'Developing Regulatory Standards'. The consultation closed at the end of July. The paper set out a regulatory approach that suggested a focus on the four constituent parts of regulation (i.e. outcomes focused regulation (**OFR**), risk identification framework, proportionate supervision and an appropriate enforcement strategy), and also detailed a series of indicators of, or criteria for, regulatory standards below each constituent part. The consultation also proposed that we would require each Approved Regulator (**AR**) to carry out an assessment of its regulatory regime against each of the constituent parts. Our objective is to embed the better regulation principles across the legal sector and to put in place a consistent and transparent approach to the oversight of the ARs.

This paper sets out the responses we have received to this work, our reactions to those responses, our current thinking on the work, the assessment process and some points for discussion. Below is a summary of the responses and our reaction:

Issue	Respondents' view	LSB initial reaction
Timescale	Very tight considering extensive changes in market at present.	Will extend timescale and be flexible when agreeing action plans.
Legal mandate	Legal Services Act 2007 (' the Act ') does not allow LSB to do this work.	The Act provides LSB with clear legal vires. This will be reflected in the decision document.
Our approach	Question about whether LSB / ARs have expertise, whether ARs will be impartial and the overall appropriateness.	Approach is consistent with other LSB processes. We will review other oversight regulators and encourage Board involvement for ARs.
OFR	Strong opposition to the wholesale imposition of OFR.	LSB believes s28(3) of the Act, together with the academic and regulatory literature, lead inevitably to OFR. However, we will be flexible in our requirements for adoption and allow exceptions where justified.
Assessment process	Concern about 'one size fits all approach', but there is a need for detailed criteria and evidence.	We will attempt to balance these conflicts by asking ARs to detail how they assure themselves that they are meeting the standards.

Recommendation(s):

The Board is invited:

- (1) to note the responses received to the developing regulatory standards consultation and the Consumer Panel's feedback
- (2) to endorse the next steps and assessment process.

Risks and mitigations

Financial: N/A.

Legal: Respondents have questioned our vires for undertaking such work. We are confident in our position and this will be made clear in our decision document. This is explained in detail in paragraph 24.

Reputational: High profile area which is one of three new LSB business priorities.

Resource: The project plan has identified the necessary resources to carry out this work, although resources are stretched across the whole organisation following the resignation of two Project Managers and a Regulatory Associate.

Consultation	Yes	No	Who / why?
Board Members:	✓		Bill Moyes and Steve Green.
Consumer Panel:	✓		We sought written feedback from the Panel to assist in the development of our thinking.
Others:	N/A.		

Freedom of Information Act 2000 (Fol)

Para ref	Fol exemption and summary	Expires
12-19	s336(2)(b) & 44 – provided by the Consumer Panel as informal advice.	Tbc.
29	s36(2)(b) – 'free and frank provision of advice'.	Tbc.

LEGAL SERVICES BOARD

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Developing regulatory standards – progress report

Background

1. Stakeholders (including the Lord Chief Justice, the Legal Ombudsman and the Legal Services Consumer Panel), some of the smaller ARs and others have prompted the LSB to set out what it believes the statutory requirements in the Act mean for the regulation of lawyers, entities and the relevant sections of the market as a whole by ARs. In addition, the Smedley research report into the smaller ARs illustrated the need for a coherent view on what the LSB expects from the ARs and how we intend to conduct our oversight of the ARs.
2. In April, LSB published the consultation paper, 'Developing Regulatory Standards' (the Executive Summary is attached at **Annex A**). The consultation closed on 12 July. The paper set out a regulatory approach that suggested a focus on four constituent parts of regulation and also detailed a series of indicators of, or criteria for, regulatory standards below each constituent part. The consultation also proposed that we would require each approved regulator to carry out an assessment of their regulatory regime against each of the constituent parts. We would review these assessments and agree areas that require attention. The consultation also committed the LSB to review its own rules, procedures and guidance to ensure that they were consistent with the position we expect of ARs.
3. The four constituent parts identified are:
 - outcomes focused regulation (OFR)
 - risk identification framework
 - proportionate supervision
 - an appropriate enforcement strategy.
4. The main objective of this work is to embed the better regulation principles across the legal sector and to put in place a consistent and transparent approach to the oversight of the ARs. A key outcome is to help deliver a legal services market in which all Authorised Persons are regulated in an efficient manner that reflects best regulatory practice, that all consumers of services from lawyers are protected from unacceptable levels of risk, and that the ARs promote the regulatory objectives. It will be an ongoing review that will also assist in assuring the LSB that the regulators are behaving appropriately. Because of the broad nature of the reviews, it is likely that this project will contribute to the promotion of most, if not all, of the regulatory objectives.
5. In order to deliver this project, the following outputs will need to be produced by the LSB:

- a decision document
 - Guidance for ARs on regulatory standards - including the amended key indicators of, and criteria for, regulatory standards and a self-assessment template
 - assessment criteria for use by the LSB
 - assessment of, and an agreed action plan, for each AR
 - a review of our existing rules, guidance and procedures and any amendments to them to ensure consistency with our new approach and standards.
6. This paper sets out the responses we have received to this work, our reactions to those responses, our current thinking on the work, the next steps and the assessment process.

Consultation responses

7. The LSB received ten responses to the Developing Regulatory Standards consultation. A more detailed summary of these responses can be found at **Annex B**. (Copies of the full responses will be available at the meeting.) Aside from a few nuances, most respondents agreed with our overview of the market. The majority of respondents supported consistency in oversight regulation across ARs and the self-assessment process which gives ARs scope to review their regulatory arrangements. However, concern was expressed with the proposed timescale and uncertainty about a 'one-size-fits-all' approach. Some respondents suggested that a tension existed between promoting the regulatory objectives through the LSB's oversight regulation and OFR, and allowing the ARs the freedom to decide how they achieve the regulatory objectives.
8. A key concern raised by the ARs was that the LSB's proposals would mean that they have little flexibility in designing their own approaches to regulation to promote the regulatory objectives and adhere to the better regulation principles. It was argued by a number of respondents that the LSB's proposed OFR model may not be the only way to embrace the regulatory objectives and achieve the desired outcome of better, proportionate and responsive regulation for their regulated communities.
9. Other respondents were critical that the LSB is being 'too activist' and has stepped beyond what the Act intended. One respondent felt we should be rolling back our regulatory remit, offering only 'advice' and 'assistance' rather than taking a primary lead. Frontline regulators also considered that the move to promote consistency across regulators may stymie their own responsiveness and actually increase the risk of regulation by transferring the initiative from frontline regulators to the LSB.
10. Another concern raised by several ARs was the proposed timescale and the risks faced by ARs in implementing regulatory changes. ARs highlighted that OFR and other regulatory changes came at a time of great change and this could increase the risk profile faced by the ARs. OFR was viewed as a change that should happen incrementally and with modifications being made by frontline regulators themselves and not being dictated to by the LSB. Several ARs pointed out that

OFR is not explicitly demanded by the Act, but that the LSB nonetheless is expecting to see it.

11. Pursuing the self-assessment and implementation of the Regulatory Standards workstream in a 12 month timeframe may have an adverse impact on other priorities for ARs. This timeframe is not seen by all ARs as proportionate and some consider that the LSB must exercise caution not to stray into the micro-management of ARs.

Consumer Panel informal feedback

12. As we received no responses to the consultation from consumers, we sought informal advice from the Legal Services Consumer Panel. We provided a short note on the work and invited Panel Members to comment on the document through a web portal. The Consumer Panel secretariat translated these comments into an informal note (**Annex C**).

[Redacted]

[Redacted]

[Redacted]

[Redacted]

[Redacted]

[Redacted]

19. [Redacted]




Initial LSB reactions

20. The responses received included a number of useful insights and aspects to consider carefully and we have taken these into account when developing the next steps. Below are some of our initial reactions to some of the main comments.
21. *Timescale:* We recognise that the timescales proposed by the initial paper were challenging and in order to ensure that we get a quality response from the regulators it is appropriate to provide more time for them to complete the self-assessment and for the agreement of the action plans. Providing more time will also enable each regulator to seek views from their Board and to provide improved feedback. Therefore, the schedule has been amended to provide four months to complete the self-assessment (from publication of the decision paper at the start of December) and a further two months to agree the action plans.
22. However, we should be wary of more delay over and above that. Introducing such a discipline in a world where it has been lacking up to now will inevitably be something of an iterative process in which improvements will be made year-on-year. It is therefore important that the first step is taken in a timely way, rather than allowing the timetable to drift as ever more refinements are made to a process that is never actually introduced.
23. The action plans should also be flexible enough to allow regulators to fit improvements in with their existing development and improvement plans, particularly if they are relatively minor. Clearly, if serious issues are exposed, it is entirely appropriate for the LSB to require immediate remediation work.
24. The work is designed to be replicable and should be repeated. However, we should not, at this stage, assume that an annual, triennial or any other timeline is appropriate across the board. As part of the agreement of the action plans with each regulator, we should agree milestones and a period in which the exercise should be repeated. This will allow us to tailor our approach to the specific circumstances, risks and level of impact for each regulator.
25. *Our mandate:* As we explained in the discussion document, we consider that:

*Section 4 [of the Act] places a positive (not passive or purely responsive) responsibility on the LSB. "The Board **must** [emphasis added] assist in the maintenance and development of standards in relation to, (a) the regulation by approved regulators of persons authorised...". We need to be satisfied that ARs are effective regulators which operate in a way that is consistent with the Better Regulation Principles. We do not agree, as has been suggested, that this means that we only assist where an AR asks or agrees that such assistance is needed. We also consider that section 4 must be read within the context of section 1, i.e. in discharging its functions the LSB must act in a way which it considers is most appropriate for meeting the regulatory objectives. There can be no doubt that the*

language of section 1 – “protecting”, “promoting”, “improving” with regard to the regulatory objectives - requires the LSB to be proactive.

26. In addition, the requirement on the LSB and the ARs to have regard to the principles of better regulation and best regulatory practice (s3 of the Act) also provide a firm basis for setting out our view of appropriate regulatory standards for legal services regulation. We must be able to assure ourselves that those we are responsible for are acting in line with the statutory requirements they have been given and that they are not allowing, or risking, unacceptable harms from occurring in the market they regulate. We will make our *vires* and the case for our proposed activities clear in the decision document.
27. *Is our approach correct?* We will learn much from undertaking this first exercise and we may wish to alter our approach for future iterations. The approach we currently intend to adopt for this first iteration is one that places the onus on the regulator to detail how it assures itself that their regulatory approach for each constituent part of regulation is appropriate. This is consistent with the processes we have adopted for the IGR dual self-certification exercise and, since we will place the onus on the regulators to demonstrate compliance, it also has similarities to our rule change application process and the approval of annual practising fee amounts. Far from micro-managing, in terms of prescribing the detail of the content of regulation or setting out specific KPIs, this is actually an organisational development approach that is wholly in line with the objectives of the Act.
28. In order to assure ourselves that we are confident in our approach, we will discuss different oversight approaches with other oversight bodies, principally the Financial Reporting Council and the Council for Healthcare Regulatory Excellence, and regulatory best practice with the Better Regulation Executive and the National Audit Office. This will help us to understand more deeply the challenges and risks of different methods of direct oversight and assessing our proposals in light of this. Our guidance will also seek to stress the importance of regulators involving independent Board members. Further, it will suggest that it is an option for regulators to use an independent assessor or outside consultant to assist in the completion, akin to an internal audit process. Regulators may also want to consider drawing on evidence – e.g. from surveys – of the views of their regulated communities, although we will steer them strongly to say that any such evidence should be complemented by evidence from users of services (and, where appropriate, other stakeholders).
29. 
30. *Outcomes focused regulation and other indicators:* The indicators and criteria as currently framed are likely to be refined in light of the responses and as we

further develop our proposals. Our initial thinking on how they will be refined is detailed below. However, we do not propose to alter the four constituent parts of regulation. We, the academic and regulatory literature and the various better regulation codes, support the inclusion of OFR as a key constituent part of good regulation. It has, admittedly, acquired a relatively poor reputation due to its association with the financial crisis. However, we do not believe that such inferences are accurate or appropriate in this context. We will make explicit references in the decision document to the various regulatory and academic sources and why they advocate such an approach.

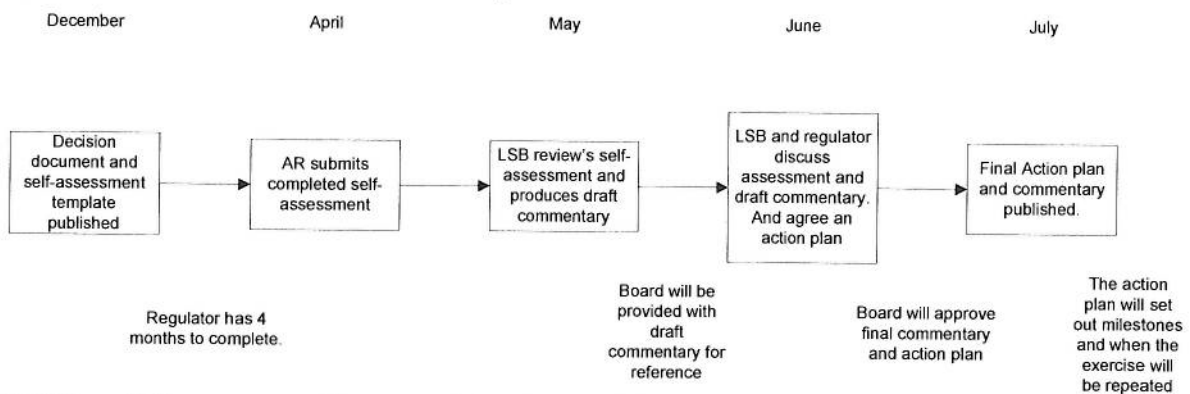
31. We will not compel regulators to move instantly to an outcomes focussed approach. But we will expect regulators to have a clear plan on how they intend to develop their regulatory arrangements so that they will accord with best regulatory practice, as required by the Act.
32. We also believe that, even in the presence of 'bright line' rules, regulators must have an understanding about why they impose each rule and what outcome they are trying to achieve and whether they are achieving that outcome. We may also accept that in some instances very specific rules may be the only realistic way to guarantee that outcomes are delivered. It could be argued that some of our requirements on complaints signposting are prescriptive in this way rather than being simply outcomes focused in a broad way. However, as with those rules, it is for regulators to justify why they impose rules rather than use outcomes.
33. *Assessment process:* The assessment template, associated guidance and criteria for assessment are fundamentally important to this work and our current thinking is detailed below. The challenges for the creation of an effective template are substantial. The template must be relevant for the most sophisticated regulator and the least. It must allow the LSB to make an assessment but not burden the regulator with too many information requirements and, where possible, it should not reinvent the wheel for those regulators that already produce relevant management information. It may also drive the production of sufficiently comprehensive and robust information for regulators not currently doing so.
34. To meet these challenges, we propose to review the relevant materials already made available by the regulators, to hold a workshop for the regulators and for LSB colleagues to discuss our approach, timescales, revised indicators and how regulators might respond to the exercise.
35. Once we have published the decision document, the LSB will also review its own internal rules, procedures and guidance to help ensure that they are in accord with the decision document's final position. The primary focus of the review will be to look at our approval mechanisms, including rule approval, applications to become licensing authorities and applications to become ARs. The ultimate objective of this work will be to ensure that no new arrangement or regulator will be approved unless it has had due regard to the four constituent parts of regulation. A secondary aspect of the work is to consider the extent to which the LSB itself utilises the constituent parts of regulation. Our role as an oversight regulator may mean that all aspects do not directly apply or require some

customisation – but we suspect that many aspects will apply and we need to be in a position to demonstrate that we are practicing what we are preaching.

Indicators and approach

36. We propose to streamline and arrange the indicators included in the consultation document so that it is easier for the regulators to assess their regulatory arrangements. This will lead to a focus on each constituent part of regulation with the underlying indicators and criteria being used as examples of good practice and we will also develop examples of poor practice.

Figure 1: Flow chart of assessment process



37. We will then expect the regulator to provide an assessment of how its arrangements operate, how it believes it achieves the requirements of each constituent part, areas where it requires improvement and planned relevant reforms. We will expect evidence where necessary and a detailed assessment of their performance and any relevant KPIs used. Ultimately, we envisage asking them how they *achieve* the standard required and how they *assure* themselves that these standards are being achieved in the markets they regulate.

38. Below is an example table as to how the assessment may operate for the area of OFR.

Outcomes focused regulation	
Principle: The outcomes that consumers should experience are the basis of the regulatory arrangements	
Good practice	Poor practice
Regulatory arrangements based on evidence and understanding of consumer needs and detriment	Rules based approach not based on regulatory need/ evidence
Recognises the public interest in legal services as part of the wider justice system.	
Guidance is clearly discretionary and does not unnecessarily restrict firms in how they deliver outcomes.	Little research on need before imposing regulatory requirements.
Education and training standards (both at entry and on an ongoing basis) ensure that appropriate standards are achieved and maintained, and encourage diversity in the profession.	Existing requirements not subject to regular review for effectiveness and appropriateness.

Regulator assessment		
Policy	Practice	Assessment and reform
<i>Regulators will explain how their arrangements achieve outcome focused regulation and how they review their arrangements.</i>	<i>They will detail all relevant information about their day to day regulatory activities. For instance they will indicate how much guidance they issue, the KPIs they set for the year and any other information relevant to being an outcomes focused regulator.</i>	<i>This will include their assessment of their own strengths and weaknesses in the area of outcomes focused regulation. They can also explain any ongoing or planned reforms.</i>

39. The above approach, or something like it, will give the flexibility and freedom for regulators to explain what they do, how they do it and how they feel they meet the requirements. It will mean that the assessment will not be overly prescriptive. We will make clear that it is not a test against which the LSB will grant marks out of ten, but instead a challenge to the regulators to account for their arrangements.

40. If the LSB identifies an area or aspect of weak performance that is common to regulators or specific to a regulator, we will consider what action will be appropriate. This may be a thematic review, an information request or other enforcement activity. Also it will be an opportunity to identify and share best practice amongst regulators.

Conclusion

41. This project is fundamental to how the LSB conducts its oversight role and also supports the development of legal services regulation that will meet the needs of consumers in the most efficient manner for practitioners. We have carefully considered the responses we received from the consultation and from the Consumer Panel and are proposing a number of modifications to the programme. However, we would welcome the Board's views on the main issues flagged up by the consultees and our reactions to them.

42. The Board may also want to consider the extent to which, if at all, this approach should inform our relationships with the OLC and SDT, with whom our statutory relationships are rather different.

43. If the Board is content with the direction of travel, we will finalise the decision document, assessment process and criteria for approval by the Board on 30 November.

22.09.11

List of Annexes:

Annex A: Developing regulatory standards consultation – Executive Summary

Annex B: Detailed summary of consultation responses

Annex C: Informal note from the Legal Services Consumer Panel