

# Developing Regulatory Standards

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Sections 3, 4 and 28, LSA 2007 place a clear responsibility on the LSB and ARs to promote the regulatory objectives and better regulation principles. This paper proposes how the LSB will gain assurance that regulatory standards and performance are effective.

**This consultation will close on Monday 11 July 2011**

## Executive Summary

### Introduction

1. In the 15 months since the Legal Services Board (LSB) assumed its full powers, the focus of activities has been on developing its approach to policy issues. Alongside this, we have started to deliver the direct regulatory part of our role through the approval of changes to regulatory arrangements and the consideration of new designation applications (for both reserved legal activities and more recently licensing authority applications).
2. As an independent oversight regulator, the LSB has a responsibility to ensure that we have a consistent and appropriate approach to the regulation of Approved Regulators (ARs). In our regulatory work we have been mindful to operate in a way which is consistent with the Better Regulation Principles. In particular, we have promoted outcome focused regulation and explained our expectations in terms of supervision.
3. In order to ensure that we maintain a consistent approach we need to develop a mechanism to satisfy ourselves that all the ARs are acting in way which is consistent with the regulatory objectives, better regulation principles and best regulatory practice. In this paper we are consulting on an approach for making such an assessment.
4. This paper highlights the changing nature of legal services and the increasing plurality within the legal services market. This has increased substantially because of changing business models, increased use of technology, greater diversity and variation amongst clients (individual and corporate) and more intense competition. The advent of Alternative Business Structures (ABS) in the legal services market may further increase these trends.
5. This greater plurality within the market produces a greater variation in the risks that regulators must tackle. Modern regulation, as enshrined in the better regulation principles, must focus on these risks in order to regulate in a manner that keeps pace with, encourages, supports and controls these changes so as to underpin the regulatory objectives.

### What sort of regulation does the LSB expect from ARs?

6. The LSB and ARs share the statutory responsibility to act and regulate in a manner that promotes the regulatory objectives. The proposal in this consultation is simply that this is likely to be achieved through a focus on four constituent parts of regulation:

- a. outcomes focused regulation
  - b. risk identification framework
  - c. proportionate supervision
  - d. appropriate enforcement strategy.
7. The shift towards outcomes focused regulation is a part of greater focus on consumer expectations and outcomes. It would be, at best, disproportionate and probably impossible to design a set of detailed rules that are effective at controlling all the risks that arise in each and every type of legal services firm. An outcomes focused model is preferred because it places freedom to operate, responsibility for delivery of agreed outcomes and accountability for success squarely with the legal services providers who are, after all, closest to their consumers.
8. If firms are to focus on delivering the outcomes that regulators set out, then regulators must be clear about the level of risk attached to different types of businesses, services and consumers. Thus it is essential that the ARs have in place not only the overarching risk identification framework but also the capability and capacity to profile each regulated entity (and where appropriate individual).
9. It follows from this that ARs should then supervise firms according to risk; deploying the greatest resources at the greatest risks so as to produce acceptable net levels of risk to the regulatory objectives. To do this, ARs need to focus on their overall capability and capacity as well as formal governance, systems and processes.
10. No regulatory approach provides for, or guarantees, zero failure. Therefore the regulatory regime must be underpinned by an effective enforcement strategy that encourages compliance, deters non-compliance and publishes transgressions appropriately.
11. The LSB proposes to work with ARs to assess their compliance with this overarching framework for modern regulation. This, we suggest, should be achieved through an initial self assessment exercise by each AR. This will give the AR the opportunity to set out its approach to the supervision of its regulated community in the light of this guidance.
12. The output from the self assessment exercise is expected to provide a basis for a range of activities including:
  - a. supervisory discussions between the AR and the LSB
  - b. agreed action plans for the AR to develop its regulatory model
  - c. thematic reviews across the ARs
  - d. supporting the LSB in its regulatory decision making processes.

## Next Steps

13. These proposals are designed to embed better regulation principles across the sector. Through the process of this consultation, the LSB proposes to:
  - a. refine its approach to overseeing regulation
  - b. develop the indicators and criteria from those set out at Annex A
  - c. develop a self assessment process
  - d. support each AR in completion of the self assessment process
  - e. review its own rules, procedures and guidance to ensure they are compliant with the post consultation position.

## **Annex A: Key indicators of, or criteria for, regulatory standards**

### **Outcomes-focused regulation**

- Outcomes that consumers should experience are the basis of codes of conduct and behaviour of authorised persons.
- 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 the outcomes.
- 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.
- Effective advisory services for regulated entities and individuals.

### **Risk assessment**

- Focus on entity as well as individuals.
- Formalised approach to risk assessment which is transparent.
- Responsive to changing conditions.
- Collection of data set and other information to determine the risk assessment.
- Should be capable of picking up individual and firm specific issues as well as wider profession issues.
- Forward looking as well as assessing risks from current data.
- Outputs determine supervision activity – themes, intensity, frequency and form.

### **Supervision**

- Activity determined by risk assessment outputs.
- Proactive as well as reactive.

- Forward looking plan of activity – focused on risks; flexible; reports produced on the progress against the plan, the findings and issues
- Responsive to changing conditions.
- Thematic as well as firm specific.

### **Enforcement**

- Predominantly targeted at breaches that are serious and undermine the regulatory objectives (perhaps alongside a set of more administrative penalties).
- Incentivises and encourages compliance.
- Fast and fair.
- Deterrent as well a punishment.
- Appeals process.
- Publicity (important for deterrence).
- Enforcement policy that sets out the approach.

### **Capacity and capability of ARs to deliver regulatory excellence**

- Clear understanding of the different areas that the regulator is responsible for.
- Number of people needed – maybe linked to the number of people / firms to be supervised; do they have enough for what they need to do?
- Type of people – skill sets; role profiles.
- Underlying governance processes, systems and controls – how will they deliver the various functions; do they know what they need to do; (independent) assessment of effectiveness; compliance with IGRs; clear mechanisms for consumer engagement in policy making processes.
- Effective Board, challenging and holding Executive to account, whilst defending regulatory independence.

## **Annex B: A list of questions raised in this document**

### ***Question 1***

Do you agree with our analysis of the changing legal services market? Are there other factors that should be taken into consideration?

### ***Question 2***

What are the key regulatory risks that arise from the changing legal services market?

### ***Question 3***

Do you agree with our focus on outcomes focused regulation; risk identification framework; proportionate supervision; and, appropriate enforcement strategy?

### ***Question 4***

How do you think that a more flexible and responsive regulatory regime should be developed?

### ***Question 5***

We would welcome views on whether self-assessment is an appropriate approach or whether LSB should deliver its oversight by conducting its own reviews.

### ***Question 6***

What benefits, costs and risks to ARs and their regulated communities are we missing?

### ***Question 7***

We would particularly welcome feedback on the criteria at Annex A, including suggestions on others that might be appropriate.