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| To: | Legal Services Board | |
| Date of Meeting: | 10 July 2013 | Item: Paper (13) 42 |

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| Title: | SRA performance | |
| Workstream(s): | Developing regulatory standards | |
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| Status: | Unclassified | |

Summary:

We have been monitoring the SRA's performance on authorisations since January 2013. This followed increasing frustration and concern from a number of sectors about the way the SRA appears to have been considering applications for ABS licences.

We have seen significant improvements in performance over the last six months. The SRA has reached a steady state of performance in relation to general ABS applications and has a plan to implement changes which have been long advocated by the LSB. We also consider that the SRA's planned process improvements have the potential to continue to improve the SRA's overall performance. It is important that these changes are implemented in full and on time; we are therefore concerned that there already appears to be some slippage.

Since the SRA has been authorising ABS firms, it has licensed a number of new entrants and the data available does not suggest that its authorisation processes are weighted against new entrants in the round. However, there does appear, both in the data and anecdotally, to be issues of delay and possibly excessive caution with ABS applicants that are regulated by other regulators (e.g. accountants, IFAs, wealth managers) and applicants that are business services firms. Our analysis suggests that a lower percentage of these types of firms have been licensed than other categories of applicants, a high percentage have withdrawn their applications or they have been work in progress for too long. The delivery of „one stop shop' business models was an important driver behind the policy intent of and Parliamentary support for the Legal Services Act 2007 (the Act). The absence of such firms may impact any review of the effectiveness of the Act adversely if its effect is to damage innovation and competition in the sector.

Recommendations:

The Board is invited to:

- a) Agree that it should continue to monitor the SRA's performance in ABS authorisation
- b) Agree that it is not currently appropriate to start a formal investigation into the SRA on the area authorisation but that it should remain willing to begin a formal investigation if planned improvements in processes and performance are not delivered within a reasonable time frame.

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| <p>c) Note that the Executive will continue to monitor the SRA's progress on its improvement plans.</p> <p>d) Note that the Executive will analyse further the experience those ABS applicants and licensees that appear to have experienced even longer delays and problems than others, as well general regulatory barriers to entry for them and produce targeted proposals if this appears appropriate.</p> <p>e) Discuss its conclusions on the paper with the SRA Board at the joint meeting on 24 July</p> | | | |
| Risks and mitigations | | | |
| Financial: | None | | |
| Legal: | <p>We have used our information gathering powers to support this project. If we decide to embark on a detailed investigation, potentially leading to enforcement, then greater legal resource will be required. Pending the outcome of any investigation, we should assume the Law Society would be willing to challenge any decision to take formal enforcement action.</p> <p>We have sought additional legal advice on our powers in relation to enforcement and oversight. The legal team are involved in all major activities.</p> | | |
| Reputational: | <p>Our strong pursuit of this subject is impacting relationships and co-operation with the SRA – both staff and Board - and may also potentially do so with other regulators. Other stakeholders – government, Law Society and investors – to the extent that it is visible to them, regard it as necessary action.</p> <p>We may also be open to the challenge that in effect we approved the SRA's process when we recommended its designation as a licensing authority. Our view is that what was described to us during the application process was fit for purpose; its implementation has not been</p> | | |
| Resource: | This work remains a significant, but thus far manageable, burden on staff, especially the senior team, but this reflects the priority which the Board has given to authorisations. Stepping up the activity level further would potentially have wider impacts. | | |
| Consultation | Yes | No | Who / why? |
| Board Members: | | X | |
| Consumer Panel: | | X | N/A |
| Others: | None | | |
| Freedom of Information Act 2000 (Fol) | | | |
| Para ref | Fol exemption and summary | | Expires |
| 26 | Section 36(2)(b)(i) – Likely to inhibit the free and frank provision of advice | | |

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| Annex B – final section of letter | Section 44 - restricted information obtained by the Board in the exercise of its functions [and therefore] must not be disclosed (s167 LSA) | |
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LEGAL SERVICES BOARD

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SRA performance

1. We have been monitoring the SRA's performance on authorisations since January 2013. This followed increasing frustration and concern from a number of sectors about the way the SRA is considering applications for ABS licences.
2. In addition to its poor performance on ABS licensing, our formal requirements to provide information under S55 of the Act revealed that there were also backlogs in applications for recognised body and recognised sole practitioner authorisation. It does not appear that the SRA Board was aware of the extent of these issues and backlogs until the LSB's intervention.
3. The SRA has, since the start of year, been running a project to make significant improvements to the area of authorisation. The LSB visited the SRA on 26 April to discuss the progress of the improvement, and any future plans for improvement. Following the last LSB Board meeting we wrote to the SRA to confirm the planned implementation dates for the changes (see **Annex A**). The SRA replied on 10 June and this reply is provided at **Annex B**. The SRA also held an event and issued a press notice on Firm Based Authorisation on 4 June 2013 and a new Director of Authorisation took up post in June.
4. At the event on 4 June 2013 the SRA previewed a draft 29 page ABS application form. This will replace the current two stage application process. The SRA letter of 10 June said that it would be put on the website during week commencing 3 June 2013. As of 28 June, this had not been done. The SRA was also due to issue guidance to staff week commencing 10 June 2013. It is not known if the SRA has completed that task. The SRA also reported that new KPIs have been implemented and reporting on these will begin in Q3. It says that the website will be constantly updated until 31 October 2013 to reflect the changes and they will survey applicants at point of decision from 30 September 2013.
5. The KPIs that have been adopted by the SRA for "firm based authorisation" include the following:
 - a) 90% of low risk application decision made within 30 days from receipt of completed application;
 - b) 100% of medium/high risk application decisions made within 6 months from receipt of completed applications;
 - c) average age of recognised body / recognised sole practitioners work in progress is less than 3 months (from receipt of application);

- d) average age of ABS work in progress is less than 3 months (from receipt of application); and
- e) average age of total work in progress is less than 3 months (from receipt of application).

There are additional KPIs in relation to quality checking, quality rating, staff vacancies and staff absence.

6. The introduction of, and reporting against, these KPIs is a welcome development. There does remain a risk that an overly long lag between an application being submitted and the SRA deeming it complete could divorce reported KPI performance from the perception / experience of the applicant, as has been the case for applicants who have approached the LSB to share their frustration in the recent past. However, the SRA is conscious of this potential risk and has assured us that it has tightened up the process for determining when an application is complete (including the issuing and payment of invoices).
7. The data provided by the SRA on 14 June 2013 showed a similar level of performance to the May and April figures. The data showed that:
 - It takes an average of 7 months from the submission of a second stage application for a firm to be granted an ABS licence, 19% of applicants had to wait over 9 months for their licence and the longest took over 400 days;
 - The SRA has reduced its work in progress from 142 applications in January 2013 to 95 in June and during this time it has closed (through withdrawals) 44 applications and granted 80 ABS licences;
 - The average age of a work in progress application has increased slightly and is now 4.5 months. 26% of the work in progress applications are over 6 months old.
8. On review of these figures it appears that:
 - a) Performance is still below the level of the new KPI in terms of work in progress
 - b) Over the last three months a steady state of performance appears to have been reached in terms of:
 - i. the number of work in progress applications (there have been around 100 work in progress applications);
 - ii. the number of work in progress applications older than 6 months (it has been around 25%);
 - iii. the overall time taken to grant ABS licences (for about 20% of applications it has taken over 9 months and 45% have been completed under 6 months); and,
 - iv. the number of new applications (between 15 and 20 a month and with a similar closure rate).
 - c) The quality and accuracy of the data in the spreadsheet provided to the LSB has improved significantly.

9. This month we took the opportunity to analyse the SRA's data to see if we could determine whether specific categories of application or new entrants to regulation by the SRA are encountering greater difficulties or a significantly longer decision making period than firms already regulated by the SRA that want to become ABS.

10. Over the last 6 months the SRA has provided the LSB with the details of 330 applications. The data provided does not make it easy to determine which applications were from existing SRA regulated firms or from new entrants. However, desk research has been undertaken by the LSB to attempt to determine a figure. We also attempted to characterise the nature of each applicant with reference to the applicant's stated services on their websites. Caution should be taken with the use of the following figures. However, the analysis has determined the following:

- a) Of the applicants 177 were from existing SRA regulated firms, 75 from those not regulated by the SRA at the time of application and for 78 their regulatory status at point of application could not be determined.
- b) The SRA has licensed 89 firms that were already regulated by the SRA (59 of whom were LDPs).
- c) 44 licences have been issued to firms not already regulated by the SRA at point of application and 22 to firms who it has not been possible to determine whether they were regulated by the SRA or not.

| | Applicants | Licensed | WIP | Withdrawn / Other |
|------------------------------|------------|----------|-----|-------------------|
| Already SRA regulated | 177 | 89 | 50 | 34 |
| Not SRA regulated | 75 | 44 | 17 | 12 |
| Not known | 78 | 22 | 28 | 24 |

d) 60% of applicants who were not already regulated by the SRA at point of application have been granted licences whereas only 51% of those already regulated by the SRA have.

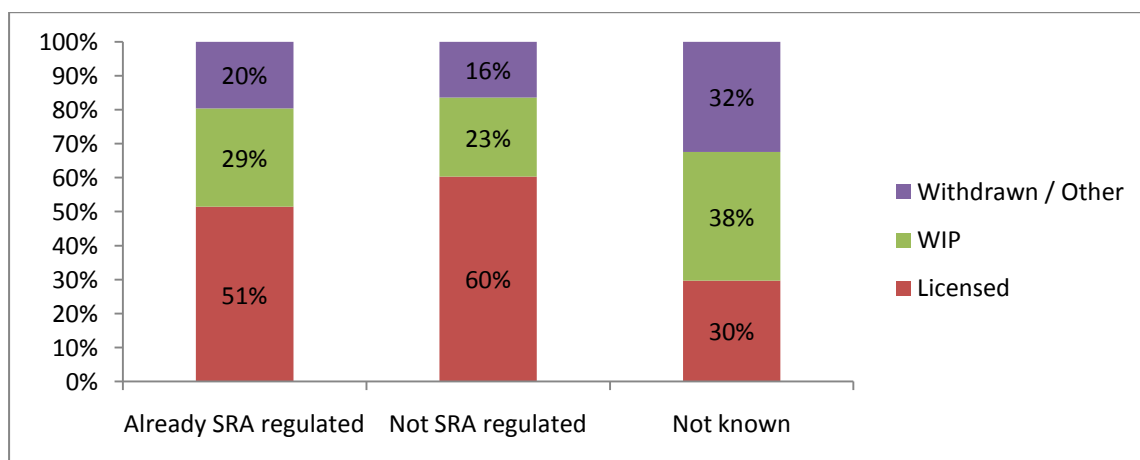


Figure 1: Breakdown of different ABS applications and their status

e) The figures suggest that it takes the SRA, on average, slightly longer to grant an ABS licence to a firm that was not already regulated by the

SRA than one it already regulated (6.8 months compared to 6.6 months).

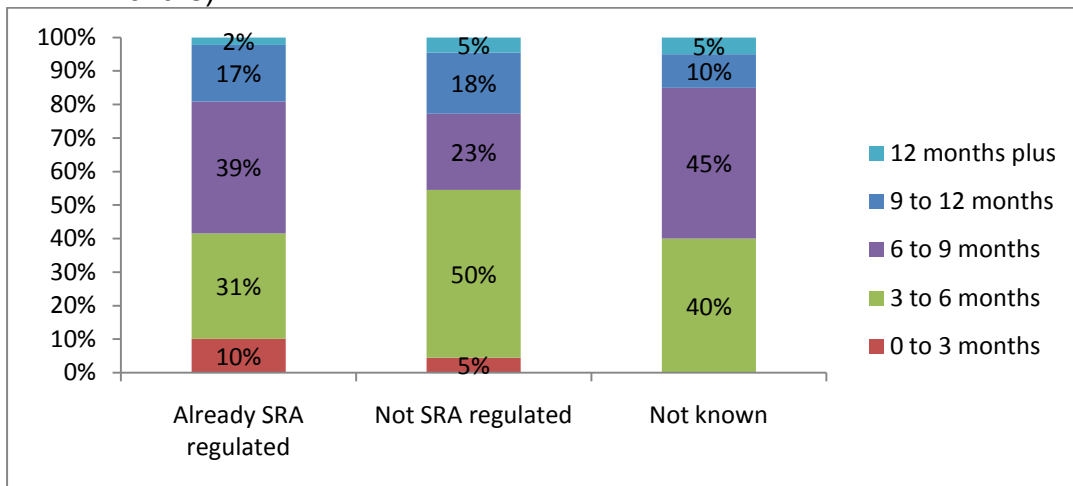


Figure 2: Breakdown of time taken for different applicants to be granted an ABS licence (following submission of a stage two application)

11. An article written by the development manager of Slater and Gordon suggests that of the “*more than 130 ABS licences issued, 86 went to UK law firms*”.¹ This finding is roughly in line with the analysis conducted by the LSB and supports the findings detailed above. However the article is not clear about the methodology used to arrive at this figure.
12. The figures detailed above are interesting but any analysis must recognise that some of the firms already regulated by the SRA have undergone significant change from their previous business form to their ABS form. For instance Parabis and Knights took on significant external investment (Parabis from a venture capital fund) and Russell Jones Walker was purchased by an Australian law firm listed on the Australian stock exchange. At the other end of the scale other ABS simply recognised an office manager as a partner. So the data should not be over interpreted.
13. However, considering the data It is possible to conclude that:
 - a) In the last 18 months or so of SRA ABS licensing, at least 28% of licences have been issued to new entrants to the regulated legal services market and possibly as many as 40% if we include those which it was not possible to determine whether they were regulated by the SRA at point of application.
 - b) The time taken for new entrants to be granted a licence, while on average longer than existing firms regulated by the SRA, does not on its own give rise to performance concerns above any existing concerns.
14. We also looked at whether different types of service offering are encountering particular difficulties when applying for an ABS licence. Definitions were determined with reference to published information on individual firms’

¹ Matt Jackson (24 June 2013), “Fresh routes to funding growth,” *The Lawyer*, <<http://www.thelawyer.com/news-and-analysis/the-lawyer-management/fresh-routes-to-funding-growth/3006272.article>> [accessed 27 Jun. 13]

websites and the absolute numbers are relatively low so the information is indicative at best.

15. The two most prevalent categories of applicants are the self styled 'full service law firms', and those firms that describe themselves as 'niche' or 'specialist', excluding those who specialise in Personal Injury (PI). The first typically will offer civil, criminal and commercial legal services to businesses and consumers (for example Stephenson's). Our analysis places these types of firms in the category 'commercial and consumer law'. The second tend to focus on a specific consumer type or legal service, for example Food Law Ltd. Our analysis places these types of firms in the category 'single legal discipline/consumer type'.
16. Research conducted by Simon Goldhill² into 138 ABS licences granted by the SRA suggested that 43 were granted to existing solicitors firms, largely small and medium-sized full service practices. 43 were issued to niche practices that were mostly existing practitioners, 25 to business focused on PI or RTA accident management, 10 to businesses focused on the corporate market, 10 to businesses looking to create a volume presence on a national (8 of which were existing or incorporate existing solicitors firms) and 5 were issued to motor insurer. Again this analysis, while based on a smaller sample, is not that different from the analysis shown in figure 3 and so provides some confidence in our work.

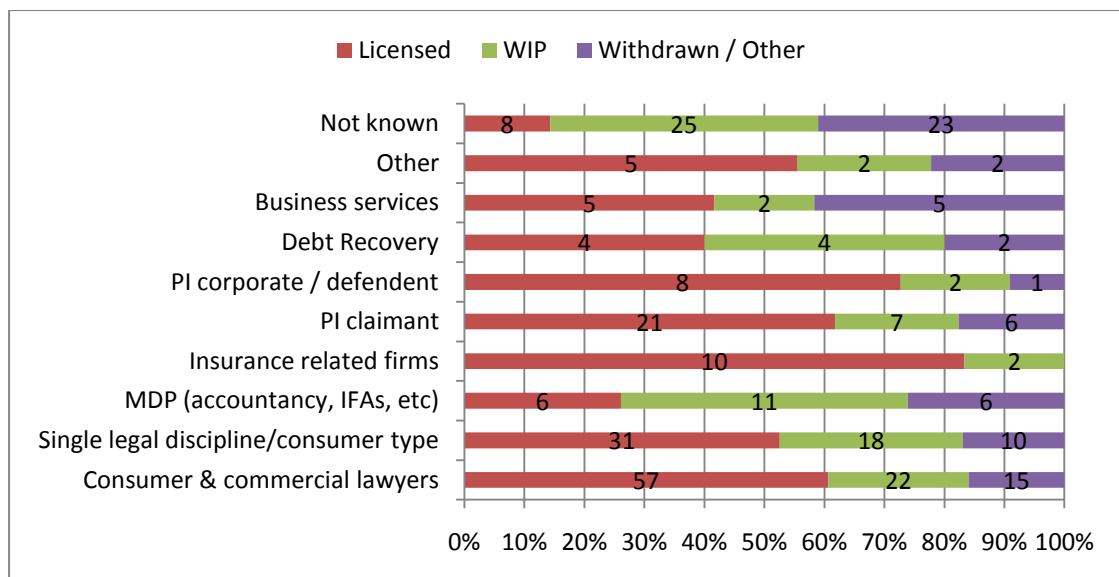


Figure 3: Breakdown of category of applicant and current status

17. The data labels in figure 3 show the absolute numbers and on the x-axis the percentage. The figure shows that, aside from firms who it was not possible to determine what services they offer, firms that are accountants, IFAs or wealth

² Simon Goldhill Consulting (2013), *Cracking the non-PI consumer legal market could be the biggest prize yet. So why is everyone looking the other way? An analysis of the grant by the SRA of ABS licences*, <<http://www.simongoldhill.co.uk/wp-content/uploads/2013/06/Where-are-the-consumer-ABSs.pdf>> [accessed 27 June 2013]

managers have been the least successful applicant type with only 25% successful applications. For this paper we are referring to them as multi-disciplinary practices – MDPs. However, these applicants are typically firms that are seeking to offer, or already do offer, a number of regulated services in addition to legal services. (e.g. they are regulated by the FCA, the accountancy regulators or other statutory regulator). Insurance firm applicants have been the most successful. The largest category (consumer and commercial lawyers) has 60% success rate and the second largest (single legal discipline / consumer type) 52%.

18. The figure shows that nearly 50% of MDP applications are work in progress (11 applications) and all of these applications have been with the SRA for at least 4 months and most of them over six months. It is also noticeable that a relatively high percentage of business services firms have withdrawn their applications. Business services firms are firms that typically offer HR or employment law type services to mainly SMEs and the entity is currently not regulated, although individuals working at the business may be regulated.
19. The data does not tell us what is driving these figures. For instance it may simply be that the forms submitted by these applications are particularly prone to error. However, anecdotal evidence and our own knowledge of the SRA's regulatory arrangements does suggest that firms who wish to offer a range of differently regulated services to businesses or individual consumers do encounter greater difficulty complying with the SRA's regulatory requirements. The principal issue encountered tends to relate to the separate business rule (which is closely related to the SRA's attitude to the scope of regulation). However, there have also been concerns about the requirements of the SRA insurance rules and the application of the practicing fee to all activities.

General conclusions

20. The SRA has reached a steady state of performance in relation to general ABS applications and has a plan to implement changes which have been long advocated by the LSB. It is important that these changes are seen through and we are concerned that there already appears to be some delay in doing so. The fact that the SRA does not appear to have delivered its promise of a full application form being available on the SRA website in line with the date promised in its letter (the letter suggested delivery during week commencing 3 June 2013).
21. We consider that the SRA's planned process improvements have the potential to continue to improve the SRA's overall performance. The conversion of LDPs (where there are minor changes) should be simple and completed in weeks not months. Firms already regulated by the SRA and bringing in non-lawyer partners and not changing activity or business model should be similarly simple to complete. These simple improvements, promised by the SRA in their KPIs, should improve the SRA's overall performance.
22. Since the SRA has been authorising ABS firms it has licensed a number of new entrants and the data available does not suggest that its authorisation processes are weighted against new entrants in the round. However, there

does appear, both in the data and anecdotally, to be an issue with MDPs and business services firms. It is surprising that so few have been licensed, and that so many have withdrawn their applications or have been in the application process for so long.

23. At present we are exploring with the SRA the extent to which weaknesses in their current rule book, approach and culture are placing particular barriers in the way of MDP applicants. The SRA has told us that it is committed to identifying a way through the complex issues concerning the way it has interprets the scope of its regulation, in particular how it approaches applicants that are already regulated. It says that it will also reconsider its approach to insurance requirements and compensation arrangements that currently present significant barriers for some applicants. Although these issues have clearly been visible ever since the initiation of the ABS process, only now does the SRA seem to be focussing on them with the attention that they merit. Hence the need for continued LSB attention.
24. These are challenging issues on their own, but they are made more complicated to solve because of the predominantly inflexible approach to non-reserved activities that the SRA takes and the rules- based culture that still pervades its operations.
25. It is possible that some applications are put off, modified or withdrawn as a result of authorisation processes. For instance the MDPs currently licensed and/or being considered appear to have undertaken or are contemplating significant structural change. If they are firms whose entry is inappropriate or only acceptable (in terms of risk to consumers) in modified form then that is a positive outcome from authorisation. However we have concerns, and significant anecdotal evidence from firms that have been through the authorisation process, that the process has not been risk based or targeted. It is not clear, for example, that decisions on “forced” restructuring have been predicated on poor compliance records with other regulators or on hard evidence of business plans that might run the risk of deliberately or inadvertently misleading consumers.
26. [REDACTED]
27. The evidence we have suggests that the current approach to the authorisation of MDPs has led to firms dampening innovation and there is no evidence that it is being effective in reducing the risk that firms may present. We expect either more evidence from the SRA to justify the current approach to the authorisation of MDPs or a greater shift of emphasis to strong supervision, rather than ex ante requirements on firm structure. It is not clear what risks from the entry of more MDPs into the market the SRA is seeking to reduce through its current rules and approach.

Recommendation

28. The Board is invited to:

- a) Agree that it should continue to monitor the SRA's performance in ABS authorisation
- b) Agree that it is not currently appropriate to start a formal investigation into the SRA on the area authorisation but that it should remain willing to begin a formal investigation if planned improvements in processes and performance are not delivered within a reasonable time frame.
- c) Note that the Executive will continue to monitor the SRA's progress on its improvement plans.
- d) Note that the Executive will analyse further the experience those ABS applicants and licensees that appear to have experienced even longer delays and problems than others, as well general regulatory barriers to entry for them and produce targeted proposals if this seems appropriate.
- e) Discuss its conclusions on the paper with the SRA Board at the joint meeting on 24 July

29. A further report will be provided to the Board in September.