To:	Legal Services Board		
Date of Meeting:	22 May 2014	**Item:**	Paper (14) 29

Title:	The SRA's approach to regulation
Workstream(s):	Regulatory standards and performance
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Status:	Official

Summary:

This paper and its related annexes provide an update on a number of inter-related issues concerning the SRA's approach to regulation. These are:

- ABS authorisations

  We have been monitoring the SRA's performance on ABS authorisations since January 2013. This followed increasing frustration and concern about the way the SRA appears to have been considering applications. . In January 2014 the Board agreed to continue the monitoring and to report on progress at this meeting. The Board also agreed that we should continue to press for the SRA to abolish the separate business rule, that the issues concerning its approach to the scope of regulation should be prioritised and that we should be prepared to tackle these ourselves in the absence of sufficiently clear commitments from the SRA. Our analysis of the most recent data provided by the SRA shows that it has continued to make improvements in its performance on ABS authorisation. The average age of its work in progress has reduced, it is deeming applications complete faster and fewer applicants are withdrawing their applications. However, we remain concerned that the average time taken to grant a licence is 7 months, that the SRA's monitoring notes suggest it is still looking closely at applicants' business plans and, whilst improvements have been made, the SRA's approach to starting the statutory decision period still gives it an extra two months to make a decision.

- Its approach to the scope of its regulatory reach – in particular for multi-disciplinary ABS

  Applicants from this sector take the longest time to be granted their licence and many have withdrawn their applications. Currently the SRA imposes its own regulatory requirements on those already regulated elsewhere (for instance chartered accountants), or else it has to issue a waiver to the separate business rule. The SRA appears to have recognised that its approach to the scope of regulation for MDPs causes duplication in regulation and conflict with other regulatory frameworks and has published a consultation document proposing a different approach. We have some

concerns about its proposals which we are discussing. The SRA has acknowledged that the separate business rule will need consideration as part of this work.

- Complexity of its ABS authorisation process

  A paper to the Board in January set out the intended approach to reviewing the impact of Schedule 13 to the Legal Services Act 2007 (LSA) on authorisation of alternative business structures. The schedule is detailed and prescriptive in nature, with numerous tests to identify those non-lawyers needing approval as well as the requirements on which the relevant licensing authority must be satisfied. Having reviewed the schedule's requirements and current licensing authority arrangements, it seems to us that the majority of problems appear related to the SRA over-engineering its approach. For example, the schedule appears to give licensing authorities discretion that the SRA has not used. There is the potential to address this quickly, through changes to processes and procedures (and related documents). The SRA seems open to discussing this with us, with a meeting arranged at the end of May.

This paper also explains briefly a number of new initiatives that the SRA is consulting on, which are clearly designed to change policy to a more targeted and proportionate approach on its financial protection arrangements.

Recommendation(s):

The Board is invited to discuss the issues in the paper and to note that:

(a) we will continue to monitor and report on the SRA's performance in ABS authorisation

(b) we will continue discussions with the SRA on its approach to the regulation of MDPs to ensure that there are no ambiguities about its intentions if rule applications are made

(c) our projects on restrictions on forms of practice (including the SRA's separate business rule) and "in house" rules will continue as planned

(d) we have revised the direction of the project looking at Schedule 13 to the LSA to focus more on working with the SRA to simplify what we consider to be its overly complex processes.

We will bring an update on all these issues to the July meeting.

Risks and mitigations	
Financial:	None
Legal:	Following consultation, the changes proposed by the SRA are likely to be submitted to the LSB as rules change applications. The issues

	that we currently have concerns about may therefore lead to the need for finely balanced – and therefore more legally risky – judgments about whether to approve the rule changes. However, at this stage no final view has been reached on any of the issues.
Reputational:	We have been publically critical of the SRA's approach to MDP ABS. Our views on its current consultation are therefore likely to be scrutinised. Criticism of licensing authority approaches and/or bringing forward changes to arrangements that were ostensibly designed to protect the integrity of legal services could lead to challenge/criticism around associated levels of risk and of our approach/remit. We are seeking to work with licensing authorities and ABS to ensure all relevant views are considered properly.
Resource:	This work can be managed within current resources.

Consultation	**Yes**	**No**	**Who / why?**
Board Members:		**X**	
Consumer Panel:		**X**	
Others:	[redacted]		

Freedom of Information Act 2000 (FoI)		
Para ref	**FoI exemption and summary**	**Expires**
Consultation: *Others* Annex D - para 12	Section 44 - restricted information under s167 LSA which was obtained by the Board in the exercise of its functions and therefore must not be disclosed	
Annex D, para 29, 32, 33-35	Section 41 – information provided in confidence	

LEGAL SERVICES BOARD

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The SRA's approach to regulation

Executive Summary

Background / context

1. The Board will be aware that we have been scrutinising a number of aspects of the SRA's performance for some time. Our analysis of its September 2012 self-assessment of its regulatory effectiveness was classed as „needs improvement and work has started' and the report highlighted some projects where there has been significant budgetary and delivery issues. We remain concerned about some important aspects of its action plan which (such as the development of its new IT system, r-view) are unlikely to be completed in line with its submitted plan.
2. However, there have been recent positive changes at executive level in the SRA and the new Chief Executive appears committed to reviewing how the organisation operates. In addition, recruitment has started for a lay Chair who will take up his or her appointment at the end of the calendar year.
3. As part of the process of change, the SRA has recently made public statements and published four consultation papers which it describes as a "wide-ranging programme of work to improve the regulation of solicitors and firms" which aims to:
   - "remove unnecessary regulatory barriers and restrictions to enable increased competition, innovation and growth to better serve the consumers of legal services;
   - reduce unnecessary regulatory burdens and cost on regulated firms;
   - ensure that regulation is properly targeted and proportionate for all solicitors and regulated businesses, particularly small businesses".
4. The SRA has also indicated a change of approach in the way it regulates small firms. It wants to engage with them more effectively and "make sure that [its] requirements are proportionate for those firms and that [it does] not set, as minimum standards, requirements that are unnecessarily onerous for them". Further detail may be announced before the meeting.
5. The SRA recognises that what it calls its current "legacy system of regulation" requires review and reform. It has therefore published a policy statement that sets out its approach to regulation and its reform (see **Annex A**). This statement includes some positive statements of intent. For example, it says that it will "take the approach that the continuation of any existing regulatory intervention needs to be justified, rather than one of focusing on justifying its removal". It also says that the current arrangements may, as a whole, provide "too great a level of intervention in the market which, in important respects, cannot be justified". Potentially this is a very important shift: historically the SRA has given equal weight to its obligations under the Solicitors Act 1974 as under the Legal

Services Act 2007. Whilst clearly existing statute remains in force and cannot be ignored, nevertheless the SRA now seem to want to interpret how to implement it in practice through the liberalising lens of the later Act.

6. We therefore consider that many aspects of the policy statement do indicate a willingness to revisit some totemic aspects of the SRA's regulation. For example, as part of the consultation on changes to PII it says that it will continue to review its PII minimum terms and conditions and other aspects of client protection to ensure a proportionate approach. In addition, it has finally put dates on its undertaking to us during our consideration of its application for designation as a licensing authority to review the separate business rule (consultation in November 2014 and decision in April 2015).

7. However, there remain some aspects of the statement that need to be clarified. For example, it is not clear what the relationship is between aspects of the new framework and the SRA's mandatory principles. Nor is it clear whether the commitment to "relentless pragmatism" will enhance or reduce transparency about the SRA's decision making processes and criteria. Finding multiple legitimate routes to a common outcome is acceptable. Varying the outcome is not.

8. In addition to its statement of policy, the SRA has published a suite of consultations, several of which we consider should, on first analysis, help to take forward its reform programme. These are:

   - changes to the arrangements for compulsory PII for regulated entities that would reduce the minimum required cover from £2m (or £3m for incorporated firms) to £500,000
   - changes to the compensation arrangements to remove the ability of large organisations and financial institutions to claim on the compensation fund
   - removing the requirement for accountants' reports on client accounts.

9. However, while this step change in its approach to regulation is welcome, aspects of the SRA's capacity and capability mean that its delivery remains challenging. These are discussed below.

ABS authorisations

10. We have been particularly concerned about the SRA's approach to ABS authorisations as a result of significant delays from the outset of its designation as a licensing authority. Although there has been an improvement over the past 12 months, there remain some key issues where we need to maintain pressure on the SRA to improve. **Annex B** analyses the latest position in more detail including issues about multi-disciplinary ABS.

Scope of regulation – MDP ABS

11. Despite the positive approach on the SRA's three consultations on aspects of its financial protection arrangements, the fourth paper that was published – about the SRA's approach to the authorisation and regulation of MDP ABS (the main paper is at **Annex C**) - gives cause for concern. There appears to be a gap between the avowed intent of the changes and how the proposal is expressed in

practice, which will need to be resolved before a rule change application is put forward.

12. The drafting certainly seems to imply a continuing belief that the SRA is the only body that should decide what types of legal and non-legal activities should be regulated, coupled with a high level of risk aversion about non-traditional entities. If that reading is right, we do not consider that, in its current form, it is likely to achieve the SRA's aim of "increased entry of multi-disciplinary ABSs to the market and ensure the regulation of such entities is targeted and proportionate". We are discussing these issues in detail with the SRA.

13. Our key concerns are:

    - The SRA starts from what it calls the "principle" that all non-reserved legal activity within an MDP must be regulated (by the SRA). There is no clear statement of what the nature of that regulation would be in practice;
    - It then sets out what we consider to be potentially onerous (and possibly impossible to meet in all but the largest firms) conditions for it to agree that some or all of the non-reserved legal activities will not be SRA regulated:

      (a) The activity not being carried out or supervised by an authorised person.
      (b) The type of activity being subject to suitable external regulation.
      (c) The ABS having procedures in place to ensure clients are aware that the activity is not SRA regulated.
      (d) The activity not being of a type that the SRA defines as integral to the provision of reserved services.

    - These conditions are further expanded in varying degrees of complexity. Of particular concern is the SRA's approach that it is the best/only judge of whether another regulator's arrangements are "suitable". Although it does state that if those arrangements have been given approval under the LSA it "will consider [them] to be suitable", this will not catch the majority of regulators operating in other sectors. We understand that the motivation is to ensure they can deter applicants from "inventing" new self-regulators as a way of avoiding any effective control, but the wording implies a significantly more prescriptive approach,
    - Finally, it proposes to impose other requirements such as having PII that meets the SRA's minimum terms and conditions which may not be appropriate in all cases.

14. A further concern is that, despite the commitment to a timetable for its review of the separate business rule, its scope and outcomes could be very restricted if the SRA starts from what it calls the "principle" that all non-reserved legal activity within an MDP must be regulated (by the SRA),

15. The SRA has set up an external reference group that will meet for the first time on 12 May. We will update the Board on developments orally.

Complexity of SRA authorisation processes

16. This issue is linked to the problems that we have identified with ABS authorisations but has focused in particular on how the CLC and SRA have implemented the complex requirements for the approval of non-lawyer owners which are set out in Schedule 13 to the LSA. **Annex D** sets out our analysis of the current position in more detail.

17. In summary, we have come to the view that the majority of problems appear to be related to the SRA having over-engineered its approach. For example, the Schedule gives licensing authorities discretion that the SRA does not appear to have used. There is the potential to address this quickly, through changes to processes and procedures (and related documents). The SRA seems open to discussing this with us, with a meeting arranged at the end of May.

Conclusion / 'next steps'

18. This is a complex web of overlapping and related significant policy issues. There is potential for many current restrictions to be removed and we are working closely with the SRA to understand its developing approach on all of them. We will keep the Board updated and bring a further paper to the July Board.