

<b>To:</b>	Legal Services Board	
<b>Date of Meeting:</b>	18 March 2013	<b>Item:</b> Paper (13) 11

<b>Title:</b>	SRA performance	
<b>Workstream(s):</b>	Developing regulatory standards	
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<b>Status:</b>	Protect	

**Summary:**

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ABS and recognised body (i.e. traditional law firms) authorisation is running at sub-optimal levels with significant backlogs having built up in 2012. There has been some significant progress in clearing these backlogs in the first three months of the year, but a more fundamental redesign of the system is required to build confidence. Aspects that we have specific concerns about include the lack of comprehensive information on the SRA website to help applicants, a two stage approach and interpretation of the six month decision period that could be seen as inconsistent with the statutory requirements and a complexity of process that has involved detailed review of business plans by the SRA and a wide interpretation of associates.

The SRA investigation and enforcement processes are complicated, difficult to map and the KPIs currently used only capture aspects of the processes used rather than the end to end process.

The separate business rule appears to be a significant issue in a number of ABS applications. The Board, in designating the SRA, noted its concerns about the rule and secured a commitment to an early review. This has not happened and the SRA has publicly rejected pressure to deliver this, despite pressure from a number of both new entrants and existing firms.

[REDACTED]

So far we have seen some significant steps on clearing the authorisation backlog and strong commitments to improve the ABS authorisation process. However the lack of progress in the other two areas combined with the fragility of the changes in authorisation mean that the Board must be vigilant over the coming months. The SRA do not agree with our assessment of their enforcement function and consider that we have not fully understood it or its effectiveness.

[REDACTED]

This paper seeks to update the Board on these areas, within the context of overall SRA performance as set out in its recent regulatory standards document.

**Recommendations:**

The Board is invited to:

- (1) To note and comment on the issues raised in this paper
- (2) To note that it will receive regular Board reports until it is satisfied at the pace of improvement in these areas

<b>Risks and mitigations</b>			
<b>Financial:</b>	None		
<b>Legal:</b>	This paper sets out some of the options for use of the LSB's formal enforcement powers following the use of our investigation powers. We therefore must be mindful of our statement of policy on enforcement and ensure that we carefully consider all the information gathered.		
<b>Reputational:</b>	This is a high profile area, which is one of three LSB business priorities. Improving regulators' performance is an essential part of making the legal services market(s) work well for consumers. The current level of SRA performance presents risks to the LSB, the SRA and regulatory system's reputations. The SRA's reaction is to accuse us of micro-management. At the same time, the BSB is challenging our work programme as mission creep and micro-management. Meanwhile, although the Law Society regularly criticises us, overall it appears to accept the need for our current focus on the SRA's performance.		
<b>Resource:</b>	Resource being used is out of existing business as usual resources and, where relevant, the Sanctions and Appeals project. There is no specific staff allocation for the analysis/monitoring of data (whether obtained by section 55 or informally) and following up subsequent queries. If investigation/enforcement activity were undertaken, separate consideration of resource requirement (and, almost certainly reprioritisation) will be necessary.		
<b>Consultation</b>	<b>Yes</b>	<b>No</b>	<b>Who / why?</b>
<b>Board Members:</b>	<b>X</b>		David Edmonds and Bill Moyes
<b>Consumer Panel:</b>		<b>X</b>	N/A
<b>Others:</b>	None		
<b>Freedom of Information Act 2000 (Fol)</b>			
<b>Para ref</b>	<b>Fol exemption and summary</b>		<b>Expires</b>
All redactions in the cover paper and Annex B	S36 – effective conduct of public affairs		N/A

## LEGAL SERVICES BOARD

<b>To:</b>	Legal Services Board		
<b>Date of Meeting:</b>	18 March 2013	<b>Item:</b>	Paper (13) 11

### SRA performance

#### Context

1. The Board published its assessment of the SRA in its regulatory standards document on 27 February. The Board will remember that there was a great deal of overlap between the SRA self assessment and our own assessment. However there were substantial differences, not least in the issues that we are considering at this point:
  - Authorisation
  - Enforcement
  - Separate business rule
2. Through the process of self assessment and general intelligence gathering, the executive came to the view that these issues warranted further and urgent investigation.
3. This paper considers the evidence and analysis of the three issues and sets out possible next steps as we seek to assist the SRA in improving its performance and tackling the identified weaknesses. The Board will note that much of this information has been previously considered as part of the regulatory standards work and was central to some of the more robust elements of our assessment. However, the matter is not resolved simply by publication of the report and ongoing activity is required to ensure that progress is made.
4. Ultimately, progress must be judged in relation to impact on the regulatory objectives. If our information gathering builds an evidence base suggesting an adverse impact, or the likelihood of an adverse impact, on one or more of those objectives, we will need to consider the appropriateness of enforcement action. Our Statement of Policy, which in turn is directly informed by section 49 of the Act, says that we will always consider whether it is appropriate, in the circumstances of the case, to resolve matters informally and will usually seek to do so before considering more formal intervention. We shall therefore have to take into account the considerable time the SRA will have had to rectify these issues in considering what, if any, action to take next.
5. The SRA has responded robustly to our regulatory standards report and business plan. It has specifically disagreed with our conclusions on enforcement activity. It considers that the LSB is too narrowly focused on certain regulatory objectives without proper regard for the wider picture, or to the roles of the LSB and the frontline regulators. The response to the draft

business plan expands on these issues and points out that the LSB does not have the information or the capacity to determine the frontline regulators priorities. This current mindset of the SRA needs to be borne in mind when considering what may be the most appropriate next steps.

6. The executive asks that the Board considers and notes the analysis and the plan for each of the three issues in this report. We will report to the Board on each issue in detail at each subsequent meeting at least until the summer and possibly beyond. We will continue to report on other relevant SRA matters beyond these three issues in the CEO's report, identifying any major issues where we identify them within the overall context of their regular public reporting.

## **A. Authorisation**

### **Background**

7. We have been aware for a number of months about increasing frustration and concern from a number of business people about the way the SRA is considering applications for ABS licences. The academic Stephen Mayson has also noted the need for the SRA to move in market time not profession time, a point that LSB spokespeople make regularly in general terms about legal services regulation. Concerns include, but are not limited to:
  - a) the processes that the SRA has developed to consider licence applications
  - b) the lack of transparency about the content of and timescales for those processes
  - c) changing requirements and expectations during the course of an application
  - d) SRA suggesting to applicants that they change actual or planned business structures in order to fit into regulatory structures
  - e) poor customer service (delay in allocating a case owner, not returning phone calls or emails)
  - f) a lack of clarity about the start date for an application that leads to delay, difficulty for applicants to track their application and delay reaching decisions. This may well be inconsistent with statutory timelines in the LSA 2007
  - g) inadequate management information on which to manage the overall authorisation process and team performance
  - h) lack of SRA Board visibility and clarity over performance of authorisation function
  - i) anecdotal evidence that non-reserved legal services and non-legal services present real problems for SRA in regulating non-traditional law businesses – related to application of the separate business rule
8. The SRA's self-assessment on regulatory standards did not mention the backlog at all. When we used our formal powers under section 55 of the LSA to get further information, we discovered that not only is the management information they do have inadequate for monitoring of progress, but that there

is also an even larger backlog of recognised body (i.e. non-ABS) authorisation applications as well.

9. We received a copy of the SRA's spreadsheet that it uses to keep track of its "stage 2" applications on Tuesday 15 January (the January submission) and Friday 15 February (the February submission). The next submission is due on 15 March and we will update the Board orally on its contents. We also received with the January submission a series of documents related to its plans for improvement in the authorisation of ABS and recognised bodies and documents from its 12 December 2012 Regulatory Risk Committee and for its Board on 23 January 2013 concerning operational effectiveness.

## **Current position**

10. The SRA also included with the January submission an outline of its project for dealing with the backlogs. The project's objectives are:
  - a) to eliminate all unnecessary delays by Easter 2013;
  - b) all incoming cases being assessed to determine approach to handling based on risk and SMT is kept informed of peaks/spikes and impact on resources;
  - c) to move the authorisation function for both ABS and mainstream firms to a more effective risk-based process using defined regulatory tools and appropriately skilled staff; and
  - d) to extract learning to inform future management of the process including robust future targets and systematic approach to engagement with applicants.
11. The spreadsheet provided as a result of the section 55 request in the January submission is, in the LSB's judgement, a rudimentary tool that only provides very basic information about each application. The spreadsheet simply records the name of applicant, the date that the "stage two" application was received, whether the "stage two" application has been deemed complete, whether the application is from an existing LDP, the current status and a space for comments. It does not provide a history of what has happened on each application and it is not suitable for monitoring overall progress, providing a detailed overview or for easily conducting analysis of trends.
12. When the January submission was provided to the LSB the SRA assured the LSB that the spreadsheet "*contains every stage 2 application received by the SRA and its current status within the process*". The SRA reported that the spreadsheet is discussed weekly with SRA staff and provides the data for the published regulatory outcomes report, CEO Board reports and other SRA reporting. We have noticed some discrepancies in the spreadsheets received so far which we have raised with the SRA. We also have concerns about the quality of the data and the inability to audit amendments to the spreadsheet.
13. The January spreadsheet contained 245 records. Detailed work conducted by the LSB on the spreadsheet revealed that for those licensed (75 records), it takes nearly 7 months (200 days) from the submission of the stage two application form to the licence effective date. The median length of time was

204 days. Of the applications still open (146 records) the average age was 5 months, however the range of open applications was larger and the oldest open stage two application was 348 days old. A total of 18 open applications had an age of between 9 and 12 months and 33 open applications were between 6 and 9 months old. It is not clear whether the SRA has ever conducted similar analysis of its performance.

14. We also reviewed the comments in the January spreadsheet. This suggested that of the 146 open applications, 80 of them required an action from the SRA and 59 of them required an action from the applicant. It was not possible to determine exactly who was responsible for the next steps for the remaining applications. A total of 15 open applications included a reference or allusion to the separate business rule or have a reference to a waiver requirement. The comparable figure for closed applications was 7.

15. The February submission included the following changes in the SRA's approach to monitoring:

- The SRA introduced a number of new status categories to more accurately characterise the position of each application.
- Those applications that were missing a status in the January spreadsheet have been reviewed and allotted a status.
- The SRA have also added a column to indicate whether the next action is with the SRA or the applicant.

16. We did not conduct the same level of analysis on the February spreadsheet. A table showing the frequency of the different statuses in the January and February spreadsheet is shown below. Please note that the reference to stage 1 and stage 2 shown below is an internal categorisation used by the SRA and does not relate to the "stage 1 application" submission or the "stage 2 application" submission that applicants are required to complete.

<b>Status</b>	<b>January</b>	<b>February</b>
Licensed	70	97
Licensed with conditions	5	7
Withdrawn	23	32
On hold	2	2
Refused	1	1
Assessment	60	<i>n/a</i>
Invoiced / invoice paid	7	<i>n/a</i>
Decision pending / report pending	18	<i>n/a</i>
Re-submission	1	<i>n/a</i>
New Application	<i>n/a</i>	19
Stage 1 - Complete Application	<i>n/a</i>	21
Stage 2 – Research	<i>n/a</i>	24
Stage 3 – Evaluation	<i>n/a</i>	3
Stage 4 - Decision	<i>n/a</i>	20
Not complete	<i>n/a</i>	23
Not complete - Application may be withdrawn	<i>n/a</i>	21
Status blank	58	0
<b>Total</b>	<b>245</b>	<b>270</b>

17. The February spreadsheet demonstrates some progress. The number of licences has risen and there is a clear indication as to whom the next action rests with for many of the applications; this stands at 77 for the SRA and 39 with the applicants. From the start of 2013 to the date of the February spreadsheet, 20 stage two applications have been received.
18. We currently have no visibility over what the SRA calls “stage 1 applications” and our concern is that the same problems that have manifested themselves at “stage 2” will be present at “stage 1”, with the potential to have a significant chilling effect on market entry: some of the apparently rapid approvals at stage 2 appear to have followed some protracted delays at this preliminary stage. Nor do we have any visibility over the backlog in recognised body applications.

### Next steps

19. We have told the SRA that we expect see progress to achieve the following:
  - a) Backlog tackled – i.e. no cases over x days old (to be defined by the SRA)
  - b) Comprehensive information about what information is needed from applicants and an application form on the SRA website
  - c) A process which starts the statutory clock when a form is first submitted to SRA, not when they deem it complete and/or receive the cheque
  - d) Clear, published KPIs with at least monthly updates on performance against them
  - e) A comprehensive suite of management information being collected, with clear visibility of what is seen and how frequently by the SRA senior executives and its Board
20. The SRA commitment is to have eliminated unnecessary delays in ABS, recognised body and sole practitioners’ applications by Easter 2013. This is defined as being that all applications will be actively assessed from the date of receipt and that they will have re-categorised each application to more accurately describe their current status. The SRA believes that this will clear a significant amount of their work in progress. They will also introduce the pre-assessment of applications to help identify the major risks/issues for each application. Also they hope to move the authorisation process to a more risk-based approach and to establish robust targets.
21. The Board will need to review the SRA’s progress in April. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

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[REDACTED]

[REDACTED]



[REDACTED]

22. Additionally we may wish to request information on the stage one applicants. The SRA would describe this stage as it being helpful to potential applicants – exploring their business model, risks and how an application might be handled. We are content that the SRA offers advice and assistance but have expressed our concern that illiberal advice or very risk averse advice may have a dampening effect on innovation by potential applicants. It may also lead to severely flawed applications being entertained, rather than clearly rejected. Equally a protracted pre-application process, the timescales for which are not caught in any KPIs, may give a false picture of the effectiveness of the end-to-end process and/or lead to the misapplication of scarce skilled resource in the SRA. An information request may help LSB to understand the number of those applicants that submit a stage one application but do not subsequently submit a stage two application. It will also give us visibility of any problems that may be present in relation to this aspect.

23. We have previously suggested to the SRA the benefit of surveying those that have received a licence, those that have withdrawn their application and those that intended to submit a stage one application but did not submit a stage two application. The purpose of such a survey is to understand applicants' experience of the process and to explore in detail the reasons for applicants choosing to withdraw or not to complete a stage two application. It is not intended that such a survey would offer analysis of particular models or applications – it is solely a customer service/experience type approach to garner feedback to help the SRA as it undertakes the review it has committed to of its processes. The SRA has refused to do such a survey because they would rather use their resources on the higher priority activities to improve the authorisation process. We may consider it a worthwhile exercise for the LSB to conduct one. If so, we will require the contact details of these applicants from the SRA. Such a survey would also help support our understanding of the effect of the separate business rule as currently constructed and applied. This has been covered in the Chief Executive's letter of 6 March to the SRA to which we have yet to receive a response, although initial discussion was not hostile.

## **B. Enforcement**

### **Background**

24. We first asked the SRA for information about the number of investigation and enforcement cases it had in a letter dated 27 July 2012. The response to these requests, received from the SRA on 1 November 2012, was not very helpful. Our analysis of the regulatory standards self-assessment also raised concerns about the enforcement function generally. We were particularly concerned that the SRA cited as evidence that its enforcement processes were effective because it had 500 cases open at any one time. We therefore issued a section 55 notice on 10 January 2013 to obtain more detailed information.
25. We are concerned about this issue because it is important that regulators are able to take action quickly against those that it considers are in breach of regulatory arrangements. It is also important for those that are having action taken against them not to have those proceedings hanging over them for an undue period of time.
26. Furthermore, the SRA's enforcement function consumes substantial resources at a time when its supervision function is new and its authorisation function weak. Improvements in this area might potentially release resources that support a faster and better authorisation function.

### **Current position**

27. The SRA responded to most aspects of the section 55 notice. However, it was unable to provide the average length of time or range of times it takes to conduct an investigation, to refer it to the SDT and to have a hearing at the SDT – the 'end to end' process. This is because the assessment files, investigation file and tribunal files are recorded separately on their system. To provide this data the SRA would have to review individually each of the cases closed in the last three years.
28. The information that they could provide showed that at the end of 2012 there were 3723 open casework investigations being handled by the supervision department. Many of these are likely to be relatively minor matters – issues that can be (and are) dealt with through effective supervision. Many are more serious or intractable and require the use of more formal enforcement tools. Nearly 10% of these investigations were over 12 months old. The average age for an open casework investigation was 5.6 months. The average age of casework investigations closed during 2012 was two months and the oldest closed case was 48 months. The average age of closed casework investigations is likely to be skewed downwards because of the large number of investigations that result in no regulatory action or are related to other ongoing action or to existing disciplinary proceedings. During quarter 3 of 2012, 94% of casework investigations were closed in these ways. Supervisors are expected to complete all casework investigations within 12 months (unless exceptional circumstances apply).

29. The figures provided by the legal and enforcement department showed that they have made progress reducing the number of open files and at the end of December it had 367 'TRI' files open – these files are opened once a decision to refer a case to the SDT has been made by a legal adviser or an adjudicator. This is down from the 500 open files described in their regulatory standards self assessment submitted at the end of September. The average age of TRI files at closure during 2012 was 19 months (closure is defined as after a judgment has been made by the SDT and, if relevant, a decision on whether the SRA will appeal has been made). The average age of unissued TRI files was 9 months and there were 18 unissued TRI files aged between 12 and 36 months old. These older cases skewed their average upwards. The SRA stated that many of the oldest cases are due to either be settled through a regulatory settlement agreement and/or rescinded.

30. As the SRA is unable to calculate the 'end to end' process we can only draw inferences from the figures provided to deduce such a figure. However, the average time from the opening of a casework investigation to the closure of a TRI file and SDT judgement appears from this analysis to be in the region of 18 to 30 months.

31. Based on these figures and the description of the process provided, our analysis of the SRA's response to that request highlighted the following concerns:

- a) The overall process from when a potential breach is identified to referral to the SDT is exceptionally complex and repetitive. For instance the decision to refer a case to the SDT is taken at three stages. It does not appear that the SRA recognises that this might be a problem;
- b) The SRA is unable to measure how long the overall process takes because its investigation team and its enforcement team use different metrics
- c) The role of enforcement is unclear. Although the SRA has explained that by the time a case reaches enforcement, a decision has been made to refer it to the SDT, it takes on average a further 6 months to issue the file at the SDT (the enforcement team has a target that 60% of cases should be issued at the SDT by 6 months and 90% in 12 months). During this time it appears to carry out a considerable amount of work on the case.

32. As acknowledged in the published regulatory standards report, the regulatory framework for the SRA is complicated by the quantity of relevant legislation. The interplay between the different statutes may be driving some of the complexity and delays found within the investigation and enforcement processes. We intend to conduct further work on the extent to which any statutory or case law requirements (as opposed to their own choices as to the use of discretionary powers) are driving the processes adopted by the SRA.

33. [REDACTED]

[REDACTED]

34. [REDACTED]

35. Our next steps are therefore focused on improving the SRA Board’s focus.

### **Next steps**

36. Getting legal research on what the drivers are for the current system – statutory requirements, case law or SRA initiated process

37. Feed back to the SRA our analysis of the issues that the current system raises

38. This will be taken forward as part of sanctions and appeals project unless evidence suggests that another course of action is necessary.

## **C. Separate Business Rule (SBR)**

### **Background**

39. The SBR prohibits SRA-authorized firms from owning, actively participating in, being owned by or connected with “prohibited businesses” providing, among other things activities such as: advocacy, instructing counsel, immigration, drafting wills and acting as a nominee, trustee or executor.

40. Our current assessment is that this rule does present a real risk to liberalisation and to the regulatory objectives. It leads to legal services that Parliament has decided (albeit not wholly rationally as we have seen in our scope of regulation work) should not be reserved being regulated as if they are reserved.

41. The SRA defends the rule on the basis that it avoids consumer confusion and that its abolition would see a flight from regulation of much of the work of traditional law firms. There is some support for their analysis from the Legal Services Consumer Panel and the Legal Ombudsman – although it does not necessarily follow that deregulation automatically leads to detriment they also claim that the issue has not been raised with them by either ABS applicants or

traditional firms at any level of the market. Conversely, it is very frequently raised with the LSB from both quarters, some of whom say they have raised it in the course of discussions on their applications.

42. However, the LSB Board's view to date has been that the risks can be managed more effectively and in a more proportionate manner through a differently constructed approach. While on our current analysis we would prefer to see the abolition of the SBR we do not suggest that there is no issue to be resolved. Indeed, our work on scope of regulation and general advice will explore some of the risks that are prevalent in what we loosely call non-reserved legal services. However, a blanket rule, rather than the ability to impose specific authorisation requirements on a case-by-case basis, seems potentially disproportionate.
43. It is worth reminding ourselves of the Board's approach to the SBR when the Board recommended designation of the SRA (TLS) as a licensing authority. It was concerned about the SBR and its impact on a liberalising market. The executive recommended that the issue could be dealt with by way of review by the SRA of its rule without threatening designation. The SRA subsequently committed to the review. That review was not delivered by the SRA, as they argued that resolution of broader issues of the scope of regulation was needed, and the LSB did not pursue it given the SRA's operational issues with PCF renewal and other operational challenges. In the latter half of 2012, discussions at executive level returned to the issue but little progress was made.
44. Throughout the autumn the executive continued to receive anecdotal and first hand concerns about the SRA's approach. These were mainly confidential discussions as the executive sought to engage with the legal market.

### **Current position**

45. On 30 January 2013 the Chief Executive wrote to the SRA to express our concern about the impact of the separate business rule on ABS applications and asked it to set a timetable for the review that it had undertaken to carry out. Our letter is attached at **Annex A** and is published on our website; the SRA's response has not been published but is attached at **Annex B**. However, we understand that it will be published as part of the SRA Board papers for its 13 March meeting.
46. The SRA's position is that the statutory framework requires them to have a separate business rule. Its position appears to be based on Counsel's opinion obtained in 2010, although the rule has existed for much longer.
47. While we understand that there will be cases where a regulator needs to prevent close associations with unregulated businesses, we consider that this outcome could easily be achieved on a case by case basis and that a blanket prohibition is disproportionate. We have, on several occasions, provided the SRA with an example of how a more targeted approach might work in practice.
48. Examples of the problems this is causing for ABS applicants are:

- Accountant (ie regulated) Tax adviser
- Unregulated tax advisor
- Law firm offering compliance analysis in competition with consultancy firm or accountant

### **Next steps**

49. We propose to undertake legal research to test the SRA's assertion that it has to have a SBR – this will set out where they have obligations to make specific rules on specific subjects and where they have permissive powers to make specific rules on specific subjects.
50. Survey of ABS applicants (current, licences granted, withdrawn) to get general feedback on the overall process and specific feedback on whether the SBR was a factor for the applicant.

### **Conclusion**

51. [REDACTED]
52. It is expected that these matters will remain live for some months. Even with a strong commitment from the SRA to tackle all three areas it is likely that the LSB will wish to monitor performance for some time in order to build confidence that the changes are leading to the desired outcomes.

### **Recommendations:**

53. The Board is invited to:
  - a) To note and comment on the issues raised in this paper
  - b) To note that it will receive regular Board reports until it is satisfied at the pace of improvement in these areas