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| To: | Board | |
| Date of Meeting: | 30 November 2010 | Item: Paper (10) 88 |

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| Title: | Smaller Approved Regulators – activities and capacity |
| Workstream(s): | Developing excellence in legal services |
| Introduced by: | Crispin Passmore, Director of Strategy crispin.passmore@legalservicesboard.org.uk / 020 7271 0086 |
| Author: | James Meyrick, Regulatory Project Manager james.meyrick@legalservicesboard.org.uk / 020 7271 0083 |
| Status: | Protect |

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| Summary: |
| <p>The purpose of this paper is to update the Board about the work of the 'Working with the Smaller Approved Regulators' (AR) project. The aim of this project is to understand, engage and support the smaller ARs' regulators, so they are all able to deliver legal services regulation that is compatible with the regulatory objectives and protects consumers.</p> <p>This paper includes a short summary of the existing smaller ARs and a discussion of some of the initial impressions of the smaller AR landscape. It also suggests some key functions that we think are reasonable to expect from the smaller ARs.</p> <p>This paper also updates the Board about the research that has been commissioned to accompany this work, which will be presented to the Board on 28 March 2011.</p> |

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|------------------------------|---|
| Risks and mitigations | |
| Financial: | None. |
| FoIA: | Pre-meeting assessment of exempted text is highlighted. |
| Legal: | None. |
| Reputational: | If the contingency plans are needed and prove inadequate, there will be risk of LSB not looking competent. Similarly, if our strategy for smaller ARs does not lead to the desired outcomes, our reputation may be damaged. |
| Resource: | Resource. |

| Consultation | Yes | No | Who / why? |
|------------------------|-----|----|-----------------------------------|
| Board Members: | ✓ | | Nicole Smith and Andrew Whitaker. |
| Consumer Panel: | | ✓ | |
| Others: | | | |

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| Recommendation(s): |
| <p>The Board is invited:</p> <p>(a) to note and to comment on the ongoing work in respect of the smaller ARs; and</p> <p>(b) to agree to re-visit the smaller AR research at the Board meeting on 28 March.</p> |

LEGAL SERVICES BOARD

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Smaller Approved Regulators – activities and capacity

Recommendations

The Board is invited:

- (a) to note and to comment on the ongoing work in respect of the smaller ARs; and
- (b) to agree to re-visit the smaller AR research at the Board meeting on 28 March.

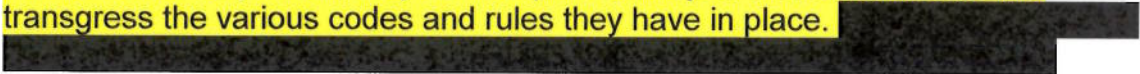

Executive summary

1. Legal Services Act 2007 (**'the Act'**) designated eight separate organisations as ARs; a further two were subsequently designated as ARs by Order. The size and scope of activities regulated by each AR varies dramatically and each AR differs too. They vary in size, in their resources available and in the activities they regulate. Additionally, their constitutions are different and they regulate practitioners providing very different services to very different types of consumers.
2. LSB is required to act as the oversight regulator for all of these ARs. The Act applies equally to all ARs; although when carrying out our regulatory activities we are required to be proportionate and targeted. Our responsibilities mean that we need to ensure that all of the ARs' activities are not having an adverse impact on the regulatory objectives, and that they are acting in accordance with best regulatory practice. These requirements presuppose a level of understanding of and engagement with all the ARs – not simply the largest.
3. For the smaller AR project, we have defined the smaller ARs as all of the ARs except for The Law Society and The Bar Council. The objectives of the project are:
 - to improve our understanding about the smaller ARs and their markets
 - to devise a strategy for the oversight regulation of the smaller ARs
 - to prepare outline contingency plans for use in the event of failure of an AR.

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4. To deliver on the following objectives:

- We will produce by the end of 2010 contingency plans for the use in the event of an AR ceasing to be viable.
- We have contracted Nick Smedley to conduct research into each of the smaller ARs and their markets. This will be completed by March 2011.
- We will develop strategies by May 2011 to support and encourage the smaller ARs to deliver outcomes-focused regulation, to categorise the risks present in their markets, to supervise according to those risks and to have credible and effective enforcement mechanisms.

The characteristics of the smaller ARs

5. **Annex A** provides some top line indicators of the scale, structure and markets of the smaller ARs. This data is drawn from the annual reports of ARs, the Section 51 applications and LSB intelligence. Despite the large differences, these indicators illustrate that a number of similarities between the ARs has been discerned during our work. Each smaller AR places a significant level of importance on maintaining high authorisation requirements. They maintain a register of those that are able to conduct reserved legal activities and, although numbers are very small, they do discipline and eject those individuals that transgress the various codes and rules they have in place. 
6. 
7. Despite these similarities, the smaller ARs do regulate very different communities. The authorised persons regulated by Institute of Legal Executives (ILEX) largely work in solicitors firms and so are subject to supervision and regulation from SRA. Although they are bound, as individuals, to follow the ILEX code of conduct and can be disciplined by ILEX in the event of poor conduct, the day-to-day monitoring and protection of consumers is regulated by SRA.
8. In a similar vein, the vast majority of notaries are also solicitors. When a notary, who is also a solicitor, carries out reserved legal activities regulated by SRA, they will follow SRA's regulatory regime as opposed to that of The Faculty Office. It is only when a solicitor notary carries out notarial activities, which SRA is not currently designated to regulate, that the solicitor notary is directly regulated by The Faculty Office.

¹ OGUS A. (2000), "Self-regulation", in B. Bouckaert et G. De Geest (eds.), *Encyclopaedia of Law and Economics, Volume V: The Economics of Crime and Litigation*, Edward Elgar, Cheltenham, pp. 587-602.

9. Authorised persons regulated by the other smaller ARs have, to a large extent, a very different client base to those of a typical solicitors' legal practice. Their clients may often be solicitors (often the case for Cost Lawyers) or larger businesses (often the case for the intellectual property professionals); and, while each will serve smaller businesses, they may comparatively rarely provide services direct to individual consumers.
10. Each of these characteristics, regulatory overlap and a more sophisticated client base, could be said to diminish the level of risks posed by the individuals and entities regulated by the smaller ARs. The one exception to this conclusion is those regulated by Council for Licensed Conveyancers (CLC). Individuals and entities regulated by CLC offer conveyancing, and to a lesser extent probate services, directly to individual consumers. In recognition of these extended risks, CLC already has a more developed monitoring and enforcement programme than the other smaller ARs.
11. The accountancy bodies have yet to authorise any individuals to provide reserved legal activities so we have not yet explored the likely risks that may be present in those markets. We have engaged with them on their likely regulatory arrangements and have made it clear that they must detail their proposed regulatory approach and how they will regulate according to the risks in their market before they begin authorising individuals to conduct reserved legal activities.

Contingency plans

12. Part of the smaller AR project is to create contingency plans that can be applied to all of the ARs, including SRA and The Bar Council. When working on these plans, we have taken an agnostic view on the likelihood of the failure of individual ARs and we **do not** expect any ARs to fail at this point.
13. The contingency plans will help ensure continuity of regulation if an AR is no longer viable to do so; they will not be for use if an AR is not competent to regulate. In such circumstances, separate support and enforcement actions will need to be considered. Some examples of what we would consider to render an AR no longer viable to regulate are:
 - lack of capital – AR does not have sufficient funds to continue operating
 - management failure – widespread management fraud renders the AR inoperable
 - loss of market – market is no longer sufficient to deliver enough revenue to continue
 - external factor or liability – AR faces financial liabilities that leave it insolvent
 - voluntary – AR decides that it no longer wishes to regulate the market [s36].
14. Each plan will consist of a document detailing any AR-specific issues that we will need to be aware of if undertaking a contingency plan, a project plan mapping out the different scenarios, options, decisions and actions that will need to be

taken and when they will need to be taken. The project plan will also include the likely timeline for the various options. There will also be a paper describing how to undertake each contingency.

15. Our objective for the contingency plan work is to create plans that will help identify the activities that LSB will have to do on day one, those in week one and those that we will have to complete to deliver a long-term solution. Our working assumption is the need to ensure that consumers remain protected in the event of a failure and that regulation continues. We will also seek to minimise the disruption to authorised persons and entities.

16. In the event of failure, we are likely to find that these plans are incomplete or that the circumstances of failure will be different to those envisioned by the plan. However, they will guide LSB activity so that we complete the right actions in the right order, we address the legal issues appropriately and ultimately enable us to act in a more measured and effective manner.

Research project

17. As part of the project, we have recruited a researcher to look into the smaller ARs and to offer recommendations on any improvements needed. **Annex B** details the tender that was put out for response. After an open tender process we appointed Mr Nick Smedley to carry out this work. Details on Mr Smedley and his project timetable are contained within **Annex C**.
18. The research is being conducted in two stages. The first stage concentrates on seeking information on the smaller ARs. This stage will look at each of their regulatory communities, the risks posed by those individuals and how each AR reacts to those risks. It will also examine each smaller AR's current strengths and weaknesses and discuss their future plans.
19. The second stage will draw upon the first stage and seek to consider the wider market in which the smaller ARs operate. It will assess whether the current activities of the smaller ARs are providing the appropriate level of protection to consumers based on the risks present in the market. If gaps are found, the research will suggest solutions to minimise these gaps or reform the market.
20. The research is currently ongoing. Nick Smedley will present his findings to the Board on 28 March 2011.

What would we expect from a good smaller AR?

21. There are a number of aspects that we think all competent smaller ARs need to have considered. This is in addition to the characteristics detailed in paragraph 5. These are:

- ARs and those they regulate should have a clear view of the outcomes that consumers have a right to expect from the services provided in their markets.
 - ARs must understand what services and type of regulated provider pose the greatest risks to consumers; and what type of consumers are most at risk. The AR should have sufficient information to categorise its regulated community and the activities conducted in its market according to these different risk types.
 - ARs must supervise their regulated community appropriately by monitoring the largest risks present within their markets and protecting those consumers most at risk.
 - When ARs uncover breaches or aspects of concern, they should be able to take credible and decisive enforcement action.
22. By undertaking these key activities, each AR will be able to focus its resources in the most necessary areas and impose the 'right' touch of regulation on their regulated communities.

19.11.10

ANNEX A

Summary of Smaller ARs – facts and figures

| | Regulatory Arm (if an AAR) | Number of authorised persons | Number of members | Number of students | Annual Revenue | Annual expenditure (same year as revenue) | Number of Staff | Qualification requirements | PC fee (2011 unless stated) | Profile of membership | Profile of consumers |
|-----------------------|----------------------------|------------------------------|------------------------------|--------------------|---------------------|---|------------------|---|--|---|---|
| ACCA | n/a | 0 | 140,225 (excluding students) | 362,000 | £132,680,000 (2009) | £129,000,000 | 968 | n/a | n/a | n/a | n/a |
| ALCD | CLSB | 267 | 757 | 159 | £413,604 (2009) | £266,996 | 3 (1 at CLSB) | 3 modules of training course, 5 years experience. Finally must attend costs lawyer course. | £500 | Employed by solicitors or working on their own account as businesses or sole traders. | Generally instructed by solicitors although a direct to consumer market does exist. |
| CIPA | IPREG | 1856 | 2758 | 604 | £1,800,000 (2009) | £1,740,000 | 12 (+3 at IPREG) | Degree plus 7 foundation papers, followed by 4 advanced papers and 2 years' employment. | £140 (non-practising), £170 (other attorneys), £280 (sole traders), £280 (entities) and £55 (attorneys working in entities or sole traders). | 3/4 of members in practice, the rest in industry. | Tend to be larger businesses although SME market important. |
| ITMA | IPREG | 783 | 1214 | 384 | £940,000 (2009) | £1,200,000 | 8 (+ 3 at IPREG) | Degree plus 5 foundation papers, followed by 4 advanced papers and 2 years' employment. | | Vast majority in practice, an 1/8 are also solicitors. | |
| CLC | n/a | 1073 | 201 | 741 | £2,493,813 (2009) | £2,493,036 | 24 | CLC foundation course, CLC final course, CLC practical training. | £400 (License fee) + Practice fee a minimum £1000, but with banded component of between 1.89% and 1.18% of turnover. | Mix of sole traders and larger firms. | General consumers. |
| Faculty Office | n/a | 883 | 883 | not known | £325,500 (2010) | £306,940 | 2 | Law degree (usually) and post graduate qualification in Notary practice. Supervised following qualification. | £340 (annual fee) + £10 (contingency fee). | All but 150 (approx) are also solicitors in practice. | Businesses conducting international trade and consumers purchasing property and such like abroad. |
| ICAS | n/a | 0 | 17,670 (excluding students) | 1030 | £14,834,000 (2009) | £13,884,000 | 130 | n/a | n/a | n/a | n/a |
| ILEX | IPS | 7409 | 21,555 | 14,146 | £6,276,000 (2010) | £6,463,000 | 100 (6 at IPS) | ILEX Level 3 Diploma, ILEX Level 6 Professional Higher Diploma (or equivalent) and a minimum of five years' employment. | £250 (fellow) | 78% in solicitors' offices, 14% in Government, 6% in commerce, 2 % Sole Traders. | As most work in solicitors office consumers will be individuals and businesses. |

Summary of smaller ARs – Reserved legal activities

| | Regulatory Arm (if an AAR) | The exercise of a right of audience | The conduct of litigation | Reserved Instrument Activities | Probate activities | The administration of oaths | Notarial activities |
|---------------------------|---------------------------------------|---|--|--|--------------------------------------|--|----------------------------|
| ACCA | n/a | X | X | X | Y | X | X |
| ALCD | CLSB | Y | Y | X | X | X | X |
| CIPA | IPREG | Y | Y | Y | X | Y | X |
| ITMA | IPREG | Y | Y | Y | X | Y | X |
| CLC | n/a | X (expected to apply for extension in 2011) | X (expected to apply for extension in 2011) | Y | Y | Y | X |
| Faculty Office | n/a | X | X | Y | Y | Y | Y |
| ICAS | n/a | X | X | X | Y | X | X |
| ILEX | IPS | Y (have applied for further rights in this area) | X (have applied for extension) | X (expected to apply for extension in 2011) | X (have applied for extension) | Y | X |

Original Invitation for tender for Smaller ARs research project

Smaller approved regulators – activities and capacity

July 2010

Purpose

1. The LSB is commissioning researchers to complete a project to study the legal services markets regulated by the smaller approved regulators (ARs) and the activities of the smaller ARs. The first aspect of the project will be to assess the services offered by those regulated by the smaller ARs, detail what the market looks like, how the smaller ARs regulate their members and the strengths and weaknesses of the smaller ARs. The second is to draw upon the findings of the first stage and assess whether the markets regulated by the smaller ARs are providing enough protection to consumers, and if not what activity should the LSB undertake to address any gaps. The research will be published in full externally and freely available to frontline regulators and other interested parties.

Background

2. One of the purposes of the Legal Services Act 2007 (the Act) was to end the 'regulatory maze' that existed in the legal services system. The Act designed a simpler structure in which the Legal Services Board (LSB) would oversee the activities of the front line regulators, now known as the approved regulators (ARs). The Act designated eight bodies as ARs, and a further two bodies have subsequently been designated as ARs by order.
3. The size and scope of activities each AR undertakes varies dramatically. For instance, the Law Society has 113,000 authorised persons and £130 million in revenue, compared to the Institute of Trademark Attorneys which has 800 authorised persons and only £1 million in revenue. It is not only the areas of size and resources in which the ARs differ; many regulate different reserved legal activities, face different issues, have different constitutions and regulate different professions. Yet the Act requires the LSB to act as the oversight regulator for all of the ARs. The LSB is required to ensure that all ARs activities, or lack of activity, are not having an adverse impact on one or a number of the regulatory objectives.
4. The overall success of the LSB agenda to improve the legal services market in the interests of consumers relies on ensuring that the LSB has a detailed understanding of the entire market, including the smaller ARs, and that the LSB takes the right policy approach towards all the ARs. The scope of these projects is to fill in the gaps of the LSB's knowledge about the smaller AR's activities and capacities, and make observations about how effectively consumers are protected in the current markets in which the smaller AR's members operate and assess whether this level of protection needs increasing.

Aims and Objectives

5. This project is part of a wider project looking at the landscape of the smaller ARs. This wider project has the following objectives;

- a. To understand more about the regulatory arrangements, capabilities and ambitions of the smaller ARs.
 - b. To devise a strategy of engagement and management for each smaller AR.
 - c. To provide support and information to other LSB work streams which impact the smaller ARs.
 - d. To prepare an outline assessment of risk of failure of all ARs and establish contingency plan for such event.
 - e. To ensure that the interests of consumers are protected by the smaller ARs.
6. This research project will primarily contribute to the first two objectives. However the findings from the research will feed into all of the objectives and should be borne in mind during the drafting of the work.
7. The first stage of the project will seek to explore the following issues:
- a. Who are the consumers of the legal services provided by individuals and entities regulated by the smaller ARs, and what is the risk of consumer detriment of these transactions?
 - b. What do the individuals and entities regulated by the smaller ARs look like; including their size, level of regulatory overlap, day to day activities and demographic issues? What risks / competitive pressures do they face?
 - c. What activities does the AR undertake to meet the regulatory objectives? How does it resource the regulation and how do they assess the risks posed by its regulatory community? How do they engage with consumers of the regulatory community's services?
 - d. What are each smaller AR's strengths and weaknesses? What are their opportunities and threats?
 - e. What are the future strategies of the smaller ARs and an assessment of the implications of the strategies for the issues identified in the answers to question (a), (b), (c) and (d)?
8. The second stage will draw upon the findings from above and answer the following questions:
- a. Given the current markets of the smaller AR's members and the operational arrangements of the smaller ARs, is the market providing the appropriate level of protection to consumers, and is it compatible with the regulatory objectives?
 - b. If the markets of the smaller ARs are not currently delivering appropriate protection for consumers or are acting in a manner incompatible with the regulatory objectives, what interventions or support could be undertaken by the LSB in order to address those areas that are not acceptable?

Issues and scope

9. We have defined the smaller ARs as all the ARs bar the Bar Council, the Law Society, ACCA and ICAS.² It may also involve discussion with other relevant stakeholders and

² Smaller ARs for this research are therefore defined as the Association of Law Costs Draftsman (ALCD), the Chartered Institute of Patent Attorneys (CIPA), the Council of Licensed Conveyancers (CLC), the Faculty Office, Institute of Legal Executives (ILEX) and Institute of Trademark Attorneys (ITMA). It will also include the activities of each AR's respective regulatory arm where appropriate.

will definitely involve consideration of wider market issues. However, the outputs will only be focused on the smaller ARs as defined.

10. Researchers are welcome to tender for the first stage only, second stage only or the whole project.
11. We invite prospective researchers to make proposals about the most effective method of answering the research questions. However, given the nature of the question we envisage the LSB providing extensive support to the appointed researcher (between two to three days a week). This support will primarily be to assist in the collection of data and the provision of information held by the LSB. Additionally we would expect the research to include a number of face to face discussions with the smaller AR's and other relevant stakeholders. The research will also be expected to gather evidence from other pre-existing sources.

Tender Evaluation Criteria

12. All projects commissioned by the LSB are subject to our standard terms of contract. Tenders will be evaluated on best value for money and will be assessed on the basis of:
 - a. Overall cost, including appropriate breakdowns.
 - b. The extent to which tenders are clearly written and meet the specified objectives, present a sound methodology, identifying any potential problems, and proposing suitable solutions.
 - c. Address outputs and ensure these are in line with requirements and the required timing of the project.
 - d. Proposed team composition, expertise and management and the organisation's diversity policy
 - e. How diversity issues would be addressed in the research.

Deliverables

Output

14. The output of the project should be an executive summary and a report with supporting evidence that addresses the specification. The report should be suitable for publication, although any decision to publish will remain with the LSB. It is essential that the report and underlying research is sufficiently robust so that the LSB can use this in discussions with external stakeholders. The research should have clear conclusions that the LSB will consider in developing future policy proposals.
15. After each stage the researcher will be expected to conduct a workshop for LSB staff and other invited guests on the findings of the research. After stage one the researcher will also be expected to present an oral report and private briefing to the LSB executive and Chairman, plus any other relevant individuals. After stage two the researchers will present the complete project to the LSB board. Additionally researchers may be asked to present the results of this analysis on a small number of occasions.
16. The LSB will retain ownership of the research, report and any underlying data.

Project plan

17. Tenders should include a project plan and time schedule for the work that identifies the main tasks and key milestones that will be used to monitor progress. The plan should be accompanied by a resource profile, giving a breakdown of the resources in person days allocated to each task.

Duration

18. We estimate that stage one will require up to 25 researcher days and stage two around 10 to 12 researcher days, although tenders with variations on this will be accepted. The research for stage one should start in September 2010. The researcher will be expected to produce an oral report and briefing to the LSB executive sometime after 22 October 2010. The research for stage two should commence in November 2010.
19. The first draft of the research project should be submitted to the LSB by 7 January 2011, with the finalised report due by 22 January 2011.
20. We will arrange interviews with all consultants who express an interest in tendering and submit a tender. These interviews will take place week commencing 23 August 2010.

Legal Services Board Contact Details

21. Tenders with any queries about the research specification should contact:
 - Policy team: James Meyrick 020 7271 0083, Research: Alex Roy 020 7271 0060
 - **Tenders must be submitted by 5pm on 20 August 2010**

Information about Mr Nick Smedley and project timings

Nick Smedley was felt to be an excellent candidate to complete the research project. His proposed methodology was appropriate for the scope of the research and his proposed outputs met the expectations of the tender in a cost effective manner. He is a respected independent and authoritative researcher with extensive experience in the area of legal services regulation and reform.

Biography

He served for many years at the Ministry of Justice. He sat on the board of ILEX Professional Standards. He has completed projects for the Bar Standards Board, the Law Society and the Cabinet Office.

His current and completed projects include:

- Law Society project considering how the Society could improve the training and post-qualification support for solicitor advocates to enable them to compete more effectively
- Law Society project considering the scope and market need for paralegal staff to obtain recognised qualifications endorsed by the Society.
- Assignment at Department for Business, Innovation and Skills (BIS) to re-structure the Government's Sector Skills Council ('Government Skills'), from an NDPB into a strategic unit in the Cabinet Office (October 2009-March 2010).
- Strategic review of the regulatory arrangements for large corporate law firms, published as the Smedley Report by the Law Society in April 2009 (October 2008-April 2009).

Research project timings

Due to existing commitments the LSB agreed that Mr Smedley could start the project at a later date than specified in the scope. The table below details the current schedule agreed with Mr Smedley.

| Activity | Elapsed days | Cumulative days | Proposed date |
|--|--------------|-----------------|---|
| 1. Scoping and set up (stage 1) | 2 | 2 | 5 Oct 2010 |
| 2. Obtaining core data from stakeholders | 1 | 3 | |
| 3. Interviews | 11 | 14 | |
| 4. Analysis and preparation of factual report | 4 | 18 | Factual report - 12 Nov 2010 |
| 5. Briefing and workshop | 3 | 21 | w/c 15 Nov 2010 |
| 6. Conclusion and closure (stage 1) | 1 | 22 | |
| 7. Scoping options for stage 2 | 3 | 25 | |
| 8. Follow-up interviews | 6 | 31 | |
| 9. Presentation to Board and preparation of final report | 6 | 37 | Final report completed -25 Feb 2011. Presentation to LSB board -28 Mar 2011 |
| Total days | 37 | 37 | |