



The Law Society

Chris Kenny
Chief Executive
Legal Services Board
Victoria House
Southampton Row
WC1B 4AD

23 October 2009

Dear Chris,

LSB Consultation on Compliance and Enforcement

I enclose the Law Society's response to the Legal Services Board consultation "Compliance and Enforcement – Statement of Policy".

The Law Society generally supports the approach taken by the Legal Services Board, subject to two major points –

- We are concerned that the Statement of Policy does not make clear that the Legal Services Board will not intervene unless the approach taken by an approved regulator was unreasonable.
- The Legal Services Board has taken what we consider to be a misguided approach to the setting of maximum fines.

It was common ground during the passage of the Legal Services Act that the Legal Services Board should seek to work in co-operation with approved regulators, and should not second guess them on matters of fine judgement. These principles were incorporated into the Act primarily through the section 49, which deals with Statement of Policy issued by the Legal Services Board. That provision requires the Board in settling its Statement of Policy both to take account of the desirability of resolving matters informally, and to take account of the principle that the Board should not intervene unless an act or omission of an approved regulator was unreasonable.

The Law Society believes the Legal Services Board needs to flesh out the current Statement of Policy so as to cover those issues more comprehensively. In particular, we believe the Statement of Policy should make it explicit that the Board will not exercise its powers unless it considers that the act or omission of the approved regulator concerned will cause significant damage to the regulatory objectives, taken as a whole.

So far as the fining power is concerned, the Law Society notes that it is extremely unusual for a fining power to exist against regulatory bodies. Provision for fines is more commonly provided for where there is misconduct through anti competitive practice, or where utilities cause consumer detriment by failing to comply with conditions of their licence. In those circumstances, very large fines indeed may well be justified in order to ensure that any profits made through the misconduct are eliminated.

The context of the Legal Services Act is quite different. Neither the approved regulators nor their regulatory arms are commercial bodies. Accordingly, the Legal Services Board simply needs to ensure it has power to impose fines which will amount to a real deterrent. A maximum fine of £1m – as used to apply in respect of the Legal Services Complaints Commissioner - is ample to provide such a deterrent to the Law Society. Smaller figures will no doubt be justified in respect of the other approved regulators.

We would naturally be happy to discuss this further with you if that would be helpful.

Yours,
Russell

Russell Wallman
Director of Government Relations

Direct Line: 020 7320 5763
Direct Fax: 020 7320 5759
russell.wallman@lawsociety.org.uk



The Law Society

Law Society response to the consultation Compliance and Enforcement – Statement of Policy

Question 1 - What are your views on the LSB's proposed compliance and enforcement strategy? If you think we should have other or additional aims, please say what you think they should be and explain why you think we should have them.

It is highly unusual for there to be fining powers over regulators. The only example we are aware of is the Legal Services Complaints Commissioner.

Regulators are generally not-for-profit bodies acting in the public interest. It is wrong to compare legal regulators with commercial profit making organisations such as utility companies. We think the LSB have drawn a false analogy between commercial bodies operating for profit, and the regulation of legal services.

Lord Hunt, in his recently published report on the future of legal regulation, made a similar point.

“Regulating a profession is totally different from regulating a utility or a natural monopoly, or even a sector such as financial services; and regulating legal services is different again from regulating any other professional sector.”

The LSB has not justified the proposed approach to enforcement powers by relating them to the legal services regulatory field. It is not enough to say that a system which has been successfully used in certain sectors is automatically transferable the legal world.

If a problem occurs which cannot be resolved informally LSB has power to direct the regulator to change. If the regulator does not take adequate steps to rectify the problem then the LSB has power to enforce its directions through the high court, and ultimately to remove regulatory powers.

Question 2 - What are your views on the matters that the LSB proposes to take into account in deciding whether (and if so what) action is appropriate? In particular, what are your views on how the LSB should judge whether an Approved Regulator's acts or omissions have been unreasonable?

We do not think the LSB have given anywhere near sufficient weight to the provision in section 49 of the Act requiring them to have regard to the principle that they should not exercise their compliance functions unless the act or admission of the approved

regulator was unreasonable. This is not the same as seeking to resolve matters informally before exercising this formal power, although there is some inter-relationship between the two concepts.

The LSB's policy statement should explicitly affirm that LSB will not seek to exercise any of its powers unless satisfied after discussion with the approved regulator concerned, that the approved regulator's approach is unreasonable in significantly prejudices one or more of the regulatory objectives without providing off-setting benefits in relation to other regulatory objectives.

Question 3 - What are your views on the informal resolution process and the timescale set out above? If you have alternative suggestions please say what they are and why you consider they are more appropriate.

We believe that the informal route should be given more prominence. The LSB state in the introduction that it will seek, "when appropriate", to resolve issues on non-compliance informally with Approved Regulators. These words are not strong enough in suggesting that the LSB will normally try and resolve issues informally at first. It is obvious that voluntary compliance is preferable. There are significant benefits for all parties in finding an agreed way forward. Informal solutions should always be explored first, except where urgent action is required to avoid an imminent risk of substantial damage to the regulatory objectives.

Question 4 - What should the LSB publish about informal resolution of an issue? Will publication help to spread learning in the regulated community or do you consider that it may hamper informal resolution of an issue? Are there alternatives that you consider would be more appropriate? Please explain your answer.

These decisions should be made on a case-by-case basis. In principle it is good practice to share lessons learnt and openness will allow stakeholders to understand why the LSB has taken certain actions. This has to be balanced against any adverse effect the making the information public will have, such as loss of confidence in a regulator.

Question 5 - What are your views on how performance targets could be used?

Performance targets are the most positive enforcement measure that the LSB can take. They will allow the Approved Regulator to make necessary changes while causing the least amount of detriment. In the vast majority of cases performance targets, which include realistic deadlines, should be used before any other sanction. But even targets should be used only where an approved regulator has acted in a way which is unreasonable.

Question 6 - What are your views on how directions should be used?

Directions should in general be used only if the Approved Regulator has not met previously designated performance targets, and only if the LSB considers that the failure to meet them – as well as the underlying behaviour of the approved regulator which led to them being set – was unreasonable.

Question 7 - What are your views on using directions to require an Approved Regulator to spend money on a specific issue?

We do not believe directions of this sort will be helpful except in circumstances where an Approved Regulator has provided an inadequate budget for regulatory purposes. In general, LSB should prescribe what it requires to be achieved rather than directly requiring money to be spent. It should be for the Approved Regulator to meet any directions or targets in a way that it feels is appropriate. This includes assessing what resources should be allocated where. It is of course sensible for them to take advice on how to achieve these goals from the LSB.

Question 8 - What are your views on how censure should be used?

Censure should be used only if performance targets or directions have not achieved the desired result, and it is plain that there is no reasonable excuse for the failure to meet targets or to comply with directions.

Question 9 - What do you think the LSB's aims should be in imposing financial penalties?

We think fining Approved Regulators is generally inappropriate.

Money taken away from an approved regulator will ultimately come from the consumer as the Approved Regulators have to pass the fine onto those they regulate, who will pass on the extra cost to those who consume their services.

Regulators do not have profit streams which can take the impact of any charge. The vast majority of money they raise goes on servicing regulatory needs. By taking money away from an Approved Regulator the LSB is impinging its ability to perform. This increases the risk that the public interest will not be as well served as it could be. The LSB should exhaust all other avenues before considering fining.

The LSB says that it is important that those who pay for the Approved Regulator should be able to influence its behaviour. In reality, that can apply only to a very limited extent. The SRA is immune from pressure from the practising profession, and the LSB would be very concerned if that were not the case.

Question 10 - What are your views on what the maximum amount of a financial penalty should be?

While the LSB consultation paper has stated the calculation method, it has not justified the maximum amount which is £28 million pounds in the Law Society's case past the simple idea that the larger the fine the greater its deterrent capacity. If one was to follow the logic of this argument you could set the fine at an astronomically high level. We believe that the £28 million is an unrealistically high amount to fine an organisation such as ourselves, never mind the LSB having the ability to fine the Association of Law Costs Draftsmen, which has fewer than 1000 members, up to £10m.

We recognise that the LSB needs to set a level for the maximum fine which is sufficient to provide a real deterrent. In the Law Society's case – as our reluctance to pay fines of the order of £250,000 imposed by the Legal Complaints Commissioner demonstrates – a maximum of £1million is ample for that purpose. For other regulators the maximum should be a lot less.

Question 11 - Is the formula proposed the right one or is there another more appropriate measure?

We think there should be an overall cap of £1million, with a minimum of perhaps £50,000; and a per capita figure of perhaps £20 a head between those figures.

Question 12 - Can you identify any circumstances when the proposed formula may be inappropriate to use?

The LSB suggests that they want to be able to levy such a large fine that it would distort the ability of an Approved Regulator to attract the regulated. The consultation paper states:

“If there is more than one Approved Regulator for a reserved legal activity and the authorised person can therefore switch to another Approved Regulator, this approach (fining) may also provide an incentive to Approved Regulators to improve their compliance.”

Fining for the reason stated above would be inappropriate. It would also be ineffective unless there was another suitable approved regulator for the activity in question.

This could ultimately lead to an Approved Regulator ceasing to exist as the demand for its services disappears. If this happens and an Approved Regulator finds itself in a position that it cannot afford to pay such a big fine it may go bankrupt. It is wrong for the LSB to cause an outcome such as this. A disproportionately high fine should not have the ability to be used as a mechanism for closing an Approved Regulator by the back door. The proper process for removing powers set out in the Act must be followed, if the circumstances justify that.

The LSB, in their Business Plan, stated they would expect Approved Regulators themselves to monitor and, where necessary, take appropriate enforcement action to ensure that the regulatory objectives and separation rules “are put into action at ground level.” If an Approved Regulator spots an issue it may wish to ask the LSB for clarification and/or assistance. If the spectrum of an unreasonable fine hangs over Approved Regulators they may think twice before informing the LSB of any problems they have. This unintended consequence is not conducive towards facilitating improved regulatory performance.

Question 13 - What are your views on whether the maximum should be linked to the total value of the services being regulated?

As the consultation paper suggests this would not be an easy exercise. Nor would it be a fair approach. The turnover of the regulated sector is hardly relevant when what is in question is the performance of the regulatory body, over which the profession has no direct control.

Question 14 - What are your views on the amounts suggested in the formula? What other amounts do you think might be appropriate, bearing in mind the need for a financial penalty to act as a credible deterrent? Please explain your answer.

These matters are dealt with in our answer to question 10 and 11.

Question 15 - What are your views on the process that the LSB proposes to use to arrive at an appropriate amount for a financial penalty?

The process is comprehensive in describing what factors are taken into account by the LSB. Where it is not clear is in suggesting how these factors may impact on the final amount that the LSB choose to fine. Our main concern is that the amount of the maximum fine is grotesquely high.

Question 16 - What are your views on the examples of the factors that the LSB may take into account when deciding what level of penalty is appropriate? What other factors do you consider that the LSB should take into account? Please explain your answer.

On the face of it the examples are fair. When the final rules are released it would be useful if each example could be accompanied by a paragraph which helps to define how the LSB will judge its relevance.

Question 17 - What are your views on the LSB's aims for using intervention directions? Are there other circumstances when you consider that the exercise of this power might be appropriate?

There is no evidence in the proposed rules that the LSB has taken sufficient account of the statutory obligation to intervene only if an Approved Regulator is failing. Section 49(4) of the Act states:

“The Board must have regard to the principle that the Board should not exercise any of those functions by reason of an act or omission of an approved regulator unless the act or omission was unreasonable.”

The consultation paper does acknowledge that the Act only permits the most interventionist powers to be used when other measures have failed to produce the desired results. It is important that this acknowledgement is clearly expressed in the rules.

Question 18 - What are your views on the LSB's aims for cancelling the designation of an Approved Regulator? Are there other circumstances when you consider that the exercise of this power might be appropriate?

The aims are in line with the Act. These powers should only be exercised as a last resort.

Question 19 - Do you think the draft statutory instrument is appropriate? If not, please say why. If you think that it should be changed, it would be helpful if you could suggest drafting changes and explain the reasons for them.

We have no additional comments on the draft statutory instrument, subject to our points on the substance of the proposed rules.

Question 20 - What are your views on each of the initial impact assessments? If you have any evidence to support your view, in particular on the possible costs involved, please provide that information.

The impact assessments were useful when comparing how the LSB approached creating enforcement rules against other rules it is currently consulting on. In section 5.14 the answer to the question “Does enforcement comply with Hampton principles?” is a simple “yes”. We do not think that is the case as the proposed maximum fine has been set at a disproportionate level. It would have been helpful if the impact assessment explained how the LSB believed they were compliant with the Hampton principles.

Question 21 - Do you agree with the approach taken to oral representation?

We agree with the approach.

Question 22 - Bearing in mind the Regulatory Objectives, the Better Regulation Principles and the need to operate efficiently in relation to the Freedom of Information Act, please could you suggest improvements to the process.

We believe that the process – as opposed to the substance of the proposals - is compliant with the Regulatory Objectives and Better Regulation Principles.

Question 23 - Do you agree with the Board's approach for making nominations for the purposes of Section 41(2)(a)?

We agree with the approach.

Question 24 - If you do not agree with the Board's approach, what alternative approach would you suggest?

The LSB need to ensure that they do not nominate any person/organisation who has a conflict of interest or might gain an unfair competitive advantage to a position within a intervened Approved Regulator. There should be enough time between appointment and taking up the position for any who are worried about these factors to raise objections.

Question 25 - Do you agree with the Board's approach for making nominations for the purposes of Section 42(3)?

We agree with the LSB's approach, subject to the concern we raised in answer to question 24.

Question 26 - If you do not agree with the Board's approach, what alternative approach would you suggest?

We do agree with the LSB's approach, subject to the concern we raised in answer to question 24.

Question 27 - Bearing in mind the Regulatory Objectives and the Better Regulation Principles, do you agree with the Board's approach to its requirements for the content of Applications?

We agree, especially as it is acknowledged that in the event of any inconsistency between these rules and the provision of the Act, the Act prevails.

Question 28 - If you do not agree with the Board's approach, what alternative approach would you suggest and why?

Not applicable.

Question 29 - Do you agree with the approach taken to oral representations?

We agree with the approach that has been taken.

Question 30 - Bearing in mind the Regulatory Objectives, the Better Regulation Principles and the need to operate efficiently in relation to the Freedom of Information Act, please could you suggest improvements to the process.

Not applicable.

Annex 7

Question 31 - Bearing in mind the Regulatory Objectives and the Better Regulation Principles, do you agree with the Board's approach to its requirements for the content of Applications?

We agree with the approach that has been taken.

Question 32 - If you do not agree with the Board's approach to its requirements for the content of Applications, what alternative approaches would you suggest and why?

Not applicable.

Question 33 - What do you think the appropriate level of, and method of calculation of the Prescribed Fee should be?

These matters are dealt with in our answer to questions 10 and 11.

Annex 8

Question 34 - Do you agree with the Board's approach for making nominations for the purposes of Section 48(3)?

We have no issues with the LSB approach.

Question 35 - If you do not agree with the Board's approach, what alternative approach would you suggest?

Not applicable.

