



## LSB CONSULTATION – DRAFT BUSINESS PLAN 2013/14

### 4 March 2013: SRA RESPONSE

- 1 This document sets out the SRA's response to the LSB's consultation on its draft Business Plan 2013/14.
- 2 The response is in three parts:
  - a response to the general approach planned by the LSB to the discharge of its statutory function as revealed by the draft plan and as experienced by frontline regulators. This sets the context within which our more detailed comments need to be considered;
  - comments on specific elements of the draft plan; and
  - proposals for additional activities that the LSB should consider adding to the draft plan.

#### Part One - The LSB's overall approach

- 3 We have significant concerns about two linked aspects of the LSB's approach:
  - the imbalance in the LSB's approach to the regulatory objectives, which tends to see the Legal Services Act in terms of narrow economic liberalisation, rather than the carefully balanced approach which the Act was designed to achieve;
  - The tendency – seen both in the LSB's past actions and in the draft plan – for the LSB to seek to intervene in the front-line regulators' exercise of their discretion, thus risking undermining the regulators' proper independence, skewing regulatory activity away from the highest risks, and leading to unhelpful and wasteful duplications of function.
4. The LSB is solely a creature of statute: the Legal Services Act 2007 (LSA 2007). Its functions and powers are defined by that Act. The Act

also impacts on the SRA (throughout this response we refer to the SRA on the basis that the SRA is discharging the regulatory functions of the Law Society which is the Approved Regulator under the LSA 2007), although the SRA's regulatory functions and its status do not flow solely from the LSA 2007.

- 5 Importantly the Act provides for regulatory objectives which apply equally to the SRA and the LSB in discharging their separate functions. In summary these are the regulatory objectives and professional principles in s.1 and the better regulation principles and regulatory best practice in ss.3 and 28.
- 6 The independently exercised functions of the LSB (including its powers over approved regulators) and SRA are tied to these common objectives.
- 7 Through the LSA, Parliament established a carefully balanced regulatory framework for legal services. The common objectives are a part of this balance. In addition, Parliament was careful to maintain independent frontline regulation of the legal services market (through the approved regulators) with a limited oversight role for the LSB, which has been given specific and limited powers over approved regulators through the Act.
- 8 In paragraph 8 of the LSB draft Business Plan, the LSB sets out its statutory responsibilities. Three of these:
  - approval and recognition;
  - regulation, education and training; and
  - scope of regulation;

are, as described in paragraph 8 by the LSB, largely uncontentious. However, it is important to note that in carrying out these statutory functions the LSB is bound to have regard to the common objectives referred to at paragraph 5 above. In addition, it is important to note that in relation to the second of these bullet points (regulation, education and training), s.4 LSA places a duty to *assist in the maintenance and development of standards*, not to direct their discharge.

- 9 It is the functions under the other two LSB headings in paragraph 8 of the draft plan ("*monitoring and investigation*" and "*enforcement and disciplinary activities*") that have, in practice, caused the most significant difficulties in the relationship between the LSB and the SRA in the past and, unless corrected, will cause increasing difficulties in the future. The LSB's approach has presented, and will in the future unless corrected present, a risk to the SRA's ability to discharge its own functions as an independent public interest regulator. This was an issue of concern at the time of the triennial review, raised by the SRA

and, more strongly, by some other approved regulators: the SRA's concerns have strengthened significantly since the review.

10 In the SRA's view, the remit provided for the LSB by the LSA in this area is properly one of oversight and to intervene in the decisions and operations of approved regulators only where such intervention is proportionate, targeted and necessary in the public interest. We have seen growing evidence that the LSB has been going beyond this approach, and the draft plan exacerbates our concerns.

11 The proper starting point for considering the LSB's role in this area is to consider the relevant provisions in the LSA which set out its functions. These are set out in Part 4 of the LSA ("*Regulation of Approved Regulators*") and the relevant provisions are:

- s.31 performance targets and monitoring
- s.32 directions
- s.35 public censure
- s.37 financial penalties
- s.41 intervention directions
- s.45 cancellation of designation as approved regulator
- s.76 cancellation of designation as a licensing authority (in Part 5 LSA)

12 The exercise of any, or all, of these functions can only be based on the LSB being satisfied:

*"that an act or omission of an approved regulator (or a series of such acts or omissions) has had, or is likely to have, an adverse impact on one or more of the regulatory objectives, and*

*that it is appropriate to [act] in all the circumstances of the case (including in particular the impact of [acting] on the other regulatory objectives."*

This provision is set out in ss. 31(2), 32(1)(a) and (3), 35(1), 37(2)(b) (in that a financial penalty can be applied for failure to comply with a direction made under s.32), 41(1), 45(5), and 76(5).

13 Furthermore, s.49 LSA 2007 requires the LSB to issue a statement of policy with respect to the exercise of the functions referred to at paragraph 11 above. S.49 provides that:

*“in preparing a statement of policy the Board must have regard to the principle that its principal role is the oversight of approved regulators (s.49(3))”;*

*“specify how, in exercising the functions ..... the Board will comply with the requirements of s.3(3) (regulatory activities to be proportionate, consistent and targeted only at cases in which action is needed, etc)”;*  
and

*“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”.*

- 14 In the SRA’s view, Parliament struck the right balance in the Act. It provided for independent front line regulation by approved regulators against clear statutory objectives. It provided for an oversight regulator with limited and closely defined powers, able to step in where approved regulators’ actions (or omissions) were a risk to the regulatory objectives but only where such intervention was necessary and proportionate and, in view of s.49(4), with regard to whether the approved regulator was acting reasonably.
- 15 However, this is not the approach that we have always experienced from the LSB or that is presaged by the LSB in the draft plan. For example, the following phrases:
- a) *“our work will increasingly be focused on regulators’ performance and on our holding them to account for delivery”;*
  - b) *“In 2013/14, we will be holding regulators to account on delivery of their performance improvement action plans...”;*
  - c) *“We will focus relentlessly on driving necessary improvements so that...”;*
  - d) *“This will be an intensive programme of work for regulators....”;*
  - e) *“There is a real leadership challenge for regulatory boards to avoid micro-management of the minutiae of policy issues, and instead focus on rigorous challenge to their executive on performance and delivery. Where this works and we see progress, with timetables that are met and agreed changes being delivered, the LSB will not need to provide guidance or direction. “;*
  - f) *“In 2013/14, we will monitor regulators’ adherence to their action plans closely and, where appropriate, take action for failure to keep to them without good reason.”*

- g) *“During the year we will review reports from each regulator on the delivery of their action plans ..... and hold them to progress....”*
- 16 These statements, particularly when taken together, are evidence of an approach by the LSB which goes well beyond the intentions of the Act, suggesting a disproportionate approach to oversight which risks undermining the independence of the regulators and adding to costs.
- 17 Properly, the LSA 2007 places the responsibility for frontline regulation in the hands of the independent approved regulators. The approved regulators have clear statutory objectives. It is for the approved regulators to decide their programmes of work and the allocation of finite resources against those plans, having regard to the risks to the regulatory objectives which they have to address. The Act allows independent approved regulators a broad latitude to decide how they should most appropriately discharge their functions and meet their statutory responsibilities. As long as those decisions are within the broad range of reasonable decisions open to the regulators and do not present significant risks to one or more of the regulatory objectives (i.e. such a risk as would give rise to any intervention by the LSB being proportionate), the LSB has no remit to set out alternate plans, substitute its own preferences for the approved regulators’ decisions or “hold regulators to account” for those decisions.
- 18 The LSB’s propensity for interventionism and micro-management (both past and planned) gives rise to more significant risks to independent public interest regulation because, in the SRA’s view, there are factors that can, and have, caused the LSB’s interventions to be misdirected. This arises because of three factors:
- a) the LSB’s continuing varying of the balanced set of regulatory objectives to focus on a small subset and on other issues not present in the statutory formulation;
  - b) its lack of capacity and capability to make good, frontline regulatory judgments; and
  - c) the risks of external pressure being applied to the LSB which it then transmits downwards on to the approved regulators.

All of these factors can result in a situation where not only is it intervening to require the SRA to take a particular course of action, but it is intervening to require the wrong course of action against a proper consideration of the regulatory objectives and/or at the risk of diverting finite resources from objectively higher priority areas of activity.

#### *Substitution of LSB objectives for the statutory objectives*

- 19 At paragraph 5 above we have referred to the LSA 2007 objectives which are common to the LSB and the approved regulators. Importantly, the LSB's functions and powers to directly "intervene" in the performance of approved regulators are triggered by reference to the regulatory objectives.
- 20 The LSB has consistently reformulated or recast these objectives into different formulations that emphasise some of the objectives rather than others and introduce new concepts not set out in the regulatory objectives. These reformulations are not wholly consistent. For example, in the draft plan, reference is made as follows:
- (a) *"....the purpose of regulation in the legal sector. Everybody recognises the importance of the rule of law, a robust legal system and a healthy legal services market to economic growth. Combined they:*
- *aid business of all kinds by guaranteeing enforceability of contracts*
  - *generate considerable revenue for the UK because of the reputation of English and Welsh courts, professions and legal education internationally*
  - *help to underpin innovation in a wide range of sectors as new commercial and not-for-profit models emerge in product and service markets in challenging economic times."*
- (b) *"Legal services regulation must play its part in maintaining and enhancing this confidence by:*
- *improving access to justice by ensuring that the legal market becomes ever more open to new, ethical business models and practitioners – it's competition, rather than barriers to entry, that acts as the best guarantor of high standards and accessible services*
  - *stripping away outdated regulatory rules where these inhibit innovation, impose unnecessary cost and/or encourage "tick box" compliance*
  - *getting to the right balance between empowering firms and individuals to make compliance decisions themselves and referring decisions to the regulator for approval*
  - *maintaining the broader underlying regulatory objectives protecting the rule of law and the professional principles*
  - *responding promptly and effectively to threats to the consumer and public interest by taking swift enforcement action when it is justified."*
- (c) *"....our primary objective of ensuring that the legal services market in England and Wales delivers the maximum possible benefits to consumers, the public and the economy."*

(d) *"Our starting point is that a competitive legal services market , underpinned by appropriate regulation, will deliver the regulatory objectives most effectively. We believe that such a market – one that works better for consumers and providers alike – would be characterised by:*

- *greater competition and innovation in service delivery*
- *access to justice for all*
- *empowered consumers, able to choose a quality service at an affordable price*
- *an improved customer experience with swift and effective redress when things go wrong*
- *constantly improving and consistently ethical legal professions, as diverse as the communities they serve*
- *clear and proportionate regulation, that protects fundamental principles, removes barriers to entry, targets market failure and commands wide confidence in the public and the market.*

*We know that this is a vision that will not be achieved over night."*

(e) *"We seek to encourage competition while ensuring that regulation:*

- *maintains the rule of law and professional principles*
- *reacts and develops to protect against and mitigate risks*
- *supports innovation*
- *incentivises a strong consumer focus and restricts the ability of providers to exploit consumers for their lack of knowledge or power."*

(f) *".....best regulatory practice for legal services regulation must be delivered in accordance with better regulation principles and comprise four constituent parts:*

- *An outcomes driven approach that gives the correct incentives for ethical behaviour and has effect right across the increasingly diverse market*
- *A robust understanding of the risks associated with legal practice and the ability to profile those regulated according to the level of risk they pose*
- *Supervision of the regulated community at entity and individual level according to the risk presented*
- *A compliance and enforcement approach that deters and punishes appropriately."*

- 21 At paragraphs 17 and 18 of the draft plan the LSB asserts that all of the regulatory objectives underpin all of its work and that there is not an over-emphasis on access, competition and consumer interests. The drafting of the plan, and the SRA's experience of the LSB's application of its approach, demonstrate that, contrary to this assertion, there is clearly a strong, and often theoretical, emphasis on economic liberalisation of the legal services market at the expense of a balanced consideration of all of the regulatory objectives as required by the LSA.
- 22 At one level, the range and variety of formulations used by the LSB as it passes the statutory regulatory objectives through the prism of its own values and objectives is simply confusing. However, the way in which these various formulations are used to underpin its interventionist approach to its role (as set out above) presents real risks to independent public interest regulation in accordance with the requirements of the LSA 2007.
- 23 It is open to the LSB to reformulate its objectives as it wishes and to be held accountable for that. However, regardless of any of these reformulations, the SRA, and other approved regulators, must have regard not to those reformulations but to the statutory regulatory objectives as they appear in the LSA. Put simply, the LSB can seek to exercise its statutory functions in respect of the SRA, properly considered and justified against the Act's regulatory objectives. It cannot, and the SRA will resist, "being held to account" against a different set of objectives formulated by the LSB – even if that has been done with the best of intentions and, in the LSB's view, "underpinned" by the regulatory objectives.

#### *LSB capacity and capability*

- 24 There is a further significant risk arising from the LSB's approach. This is that it is ill placed, in terms of capacity and capability, to drive the detailed programmes and activities of frontline regulators as it has sought, and continues to seek, to do. First, it is too far removed from the information and day to day knowledge available to the frontline regulators to second guess their decisions on relative priorities to mitigate regulatory risk. The SRA, in common with other approved regulators, has finite resources and is continually making decisions to shift those resources in order to address the highest or most immediate risks. Poorly informed interventions by the LSB seeking to require the SRA to address LSB priorities cut across the efficient and effective allocation of those resources. Second, the LSB does not have sufficient experience (either corporately or within its staff profile) of frontline professional and conduct of business regulation in order to make robust decisions on priorities.

#### *External pressures*



- 25 A significant concern at the time of the passage of the LSA and the establishment of the LSB was that the regulation of the legal professions and the sector more generally had to remain independent: particularly independent from government and independent from other improper external influences.
- 26 The carefully balanced structure of the Act was in part designed to address that concern. The LSB, being closer to government than the approved regulators, was a particular point of concern. Those concerns were partly addressed by the limited oversight role of the LSB and the clarity and transparency of its functional powers over the approved regulators.
- 27 There is a risk that the LSB could be perceived as aligning its own, economic liberalisation agenda too closely with the political objectives of the government of the day. Whether or not it does is a matter for the LSB, and we take no view. However, it is critical that the approved regulators are able to resist any such influence by ensuring that the LSB holds them to account against the statutory objectives but no more.
- 28 In addition, the LSB is contacted by regulated individuals and some seeking authorisation to discuss their individual cases. There are significant risks associated with this if the LSB involves itself too closely and/or seeks to intervene in individual cases or pressure regulators to act in particular ways. These risks are increased by the interventionist approach taken by the LSB and would be lessened by a reversion to the oversight role provided for by the LSA.
- 28 It is already clear, in the accounts of individuals involved at the time, that financial services regulators were subject to political pressure to adopt a “light touch” approach to regulation, both generally and in individual cases. This was justified on the basis of the economic benefits that would flow from such a regulatory approach. It is now readily accepted that this pressure, and the failure on the part of regulators to resist it, was a contributory factor in the negative outcomes we have seen from the financial crisis. In the SRA’s view it is critical that we take heed of these lessons and ensure the same mistakes are not repeated in the legal services market.

*Part One – Summary*

- 29 To summarise, the SRA’s view is that the LSB has taken a too interventionist and directive approach which, in our view, is inconsistent with the role of the LSB envisaged by the legislation, as an oversight regulator; and if adopted unamended, this plan would continue that approach.

We consider that the LSB has, and if unaddressed, will continue to:

- seek to substitute its own assessments of how the approved regulators should discharge their regulatory responsibilities for those decided independently by the regulators;
  - assume the right to determine the regulators' activities and the allocation of finite resources in accordance with its own priorities, thus undermining the regulators' prioritisation and allocation of resources in accordance with their own assessment of risk; and
  - fail to take account of the cumulative burden of its individual requirements and the impact these requirements have on other regulatory activities.
- 30 This approach runs the risk of undermining the regulators' ability to regulate independently and effectively in the public interest. In addition, the position is made worse by:
- the LSB's lack of balance in its consideration of the regulatory objectives with an over-emphasis on some at the expense of others – it has in effect created its own set of objectives and is seeking to require the SRA and others to operate against those rather than the more balanced approach set out in the LSA 2007; and
  - necessarily the LSB does not have the information necessary to determine the front line regulators' priorities nor the capacity and capability to do so as it is not itself a front line regulator and has not been structured as such;
  - the risks to the independence of frontline legal services regulation arising as a result of the LSB stepping outside of the boundaries Parliament constructed in defining its role and which were, in part, designed to maintain the independence of approved regulators.
- 31 For these reasons we believe that the draft plan needs significant amendment and recasting so as more properly to reflect the LSB's statutory role and the proper balance of responsibilities.

## **Part Two – Specific Comments**

### *Plan Foreword*

- 32 Many of the SRA's specific concerns with the detail content of the Plan have been addressed above.
- 33 The Foreword states:

*“In 2013/14, we will monitor regulators’ adherence to their action plans closely and, where appropriate, take action for failure to keep to them without good reason.”*

This is a message repeated a number of times in a number of slightly different formulations, including the phrase, *“holding them to account for delivery”*.

- 34 First, the SRA does not recognise the term “action plan” and does not consider that it has agreed one with the LSB: nor is it necessary to do so. The SRA has published its Strategic Plan 2013/15 which sets out its programme of work during that period, and has formulated its business plan for 2013. Responsibility and accountability for those plans rest with the SRA Board with further oversight provided by the Law Society’s Business and Oversight Board, which comprises independent members and representatives of both the Law Society and the SRA. The detail of the plans will evolve and change over time as the external environment and the risks that must be managed by the SRA change. Inevitably resources, and therefore plans and timetables, will be amended accordingly to address new pressures and mitigate new or increased risks.
- 35 The SRA will keep the LSB informed as plans change and will always be ready to discuss, explain and engage with the LSB about the plans and delivery against them. That is the proper way in which the SRA should retain its independence to formulate its plans within the regulatory objectives, while enabling the LSB to exercise its clearly defined oversight role.

#### *Plan Introduction*

- 38 We have commented on much of the material in the Introduction. We are concerned about aspects of the approach in the section on equality objectives, as this is an area where the LSB has directly intervened in the work of frontline regulators with a direct impact on workloads and cost and set prescriptive approaches that have impacted directly on regulated entities. We support the LSB’s three objectives set out on page 13 of the draft. However, we are concerned about the LSB’s planned approach to objective one.
- 39 The approved regulators must have regard to the regulatory objectives, which include the need for a diverse legal profession. In addition, the approved regulators are subject to the same general statutory equalities duties as the LSB. The SRA is committed to meeting those obligations and it, and the other approved regulators, should be allowed to approach and manage this issue as it, in its own view, appears best suited to address the issue. The LSB is fully aware of the SRA’s well-developed and published strategy in this area. The LSB needs to step back from defining in detail the approach that approved regulators should take.

*Proposed work programme for 2013/14*

- 40 In the SRA's view the thrust of this section (paragraphs 14 to 18) is not appropriate to the LSB's statutory remit and does not properly reflect its role. The section needs fundamental reconsideration.
- 41 Within this section, the LSB makes no attempt to assess the cumulative impact of its planned programme and requirements on the approved regulators and therefore on the regulated community. Given the focus in the plan on assessing the burden and cost of regulation we believe this is a deficit. The LSB needs to take greater account of the cumulative impact of its requirements on frontline regulators, assess it and be transparent about that assessment. Furthermore, given the LSB's views on the importance of risk-based regulation for approved regulators, it is unclear upon what risk basis the LSB's priorities have been set.

*A: Regulator performance and oversight*

- 42 In paragraph 19, the LSB repeat that they believe that best regulatory practice for legal services regulation must be delivered in accordance with better regulation principles and comprise four constituent parts (OFR approach, risk, supervision and compliance and enforcement). In our response to the initial consultation on the regulatory standards, we pointed out that *'we agreed that these (OFR approach, risk, supervision and compliance and enforcement) are the core functions of a regulator, although we suggest a greater focus be given to high entry standards, regulating the perimeter and equality and diversity. The focus on core functions may not be sufficiently flexible to provide the required improvements for consumers of legal services.'*
- 43 Given the emphasis that the LSB has placed on the importance of effective and efficient authorisation processes in respect of ABSs (an importance with which the SRA agrees) , the LSB may wish to revisit this approach.
- 44 We are concerned by the number of reporting burdens suggested in paragraphs 28 to 33. As the LSB has suggested, the front-line regulators' focus must be on delivery and therefore it would be helpful to have a better understanding of what the implications of frequent reporting to the LSB will be, so that we can plan for any impact on our ability to deliver. The LSB will be aware of concerns expressed by those completing the regulatory standards assessment, relating to the resource intensive nature of the work. We would hope that the LSB will be mindful of this as it plans how it expects regulators to report.

### *Section B: Strategy development and research*

- 45 As already announced and discussed with the LSB, the initial LETR report will not be published before May 2013 (paragraph 66).
- 46 We are concerned about the proposal in paragraph 67 that diversity information requirements by the LSB might be changed in future years. We have already highlighted our views on this issue generally. However, the LSB needs to have greater awareness of the operational issues, for frontline regulators and regulated entities, which arise from changing information requirements.
- 47 The research programme seems ambitious, and it would be helpful to see some prioritisation of the proposed programme, as well as indication of the outcomes of the proposed research, and what the LSB intends to do with them. It would be interesting to understand how the LSB has arrived at the research programme, and particularly how the needs of, and risks to, consumers have informed the prioritisation. We note the proposal in respect of jointly funded research. The SRA has also chosen to significantly reduce its research budget for 2013, and has planned a programme of research closely aligned to our key priorities. The SRA is not in a position to fund any additional research above that to which it has already committed. In addition, the LSB should undertake an assessment on the cumulative impact on approved regulators of its research programme in terms of the resources that will have to be diverted to providing information and input to the various projects.

### *Section C: Statutory decision making*

- 48 In paragraphs 89 to 90 of the draft plan reference is made to the LSB's approach to the approval of approved regulators' regulatory arrangements. It is as important in this area, as in the areas referred to above, that the LSB adheres to the remit provided for it by the LSA. It is of concern that paragraph 90 focuses on the LSB's own formulation of what it considers to be the necessary elements of regulation rather than the statutory requirements of the LSA.
- 49 In paragraphs 93-94, the LSB set out the approach to be taken to this year's dual certification of regulatory independence. We welcome the proposal that this will be targeted at specific issues for each applicable approved regulator, but would be keen to see the detail of this as soon as possible. However, we are not sure whether the LSB's proposal to publish a discussion document on their future approach to independence is something on which the LSB should be focusing their limited resources throughout the course of the year.

### *Delivering our plan*

- 50 The strong wording regarding the LSB's intentions needs to be supported by robust deliverables. The tables in annex 3, showing the milestones for 2013/14 have broad timeframes for delivery, and no indication of who is responsible for delivery. The plan would also benefit from a clear set of outcomes. Finally, given the dependency for delivery that the LSB has on many of its stakeholders, it might be helpful for the plan to show some consideration of this.
- 51 It would also be helpful to see where the LSB intends to focus its resources – that is what proportion of its resources will focus on particular areas.

### **Part Three – additional activities**

- 52 Although there is experience of economic regulation within the current staff profile of the LSB, it is not clear that the organisation as a whole has sufficient knowledge or experience of the regulation of professions and conduct of business regulation. In our view this is a significant deficit and should be addressed by specific measures in the plan.