

# Developing Regulatory Standards

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Summary of responses to the consultation on developing regulatory standards and decision document

## **This Decision Paper will be of interest to:**

Approved legal regulators

Providers of legal services

Legal representative bodies

Legal advisory organisations

Other third sector organisations

Consumer groups

Law schools/universities

Legal academics

Members of the legal profession

Accountancy bodies

Potential new entrants to the ABS market

Think tanks

Political parties

Government departments

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## Executive summary

1. This document explains how the LSB will assess whether the approved regulators are acting in ways that are compatible with the statutory requirements they have been given by the Legal Services Act 2007 (**the Act**) and that they are not allowing, or risking, unacceptable consumer detriment in the markets they regulate.
2. The statutory requirements include the duty to, as far as is reasonably practicable, act in a way which is compatible with the regulatory objectives and to have regard to the better regulation principles and best regulatory practice. The LSB's considers that best regulatory practice for legal services regulation must consist of four constituent parts. These are:
  - An outcomes-driven approach to regulation that gives the correct incentives for ethical behaviour and has effect right across the increasingly diverse market.
  - A robust understanding of the risks to consumers associated with legal practice and the ability to profile the regulated community according to the level of risk.
  - 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.
3. Only with the effective implementation of all of the constituent parts of regulation by the Approved Regulators will a more flexible consumer focused and responsive regulatory regime for legal services emerge. This will result in a regulatory regime that delivers efficient and appropriate regulation for practitioners while ensuring that the public and consumers are protected from unacceptable levels of risk.
4. Effective delivery of the constituent parts of regulation, should lead to higher standards of professional conduct and competence. It should catalyse a legal services market with increased consumer choice and confidence. It should encourage innovative practitioners who, if posing few risks, are not subject to intrusive or inflexible regulation. It should introduce a level of consistency in the approach to the regulation of legal services. Therefore it is against these constituent parts that we will assess all Approved Regulators.
5. The LSB will not define exactly how an approved regulator must deliver each constituent part; the LSB will expect each approved regulator to explain, with evidence, how its arrangements are delivering each aspect. The LSB will also assess approved regulators for their capacity and capability to deliver the regulatory objectives.
6. Within this work all the regulatory objectives are important. However, it remains the LSB's view that the regulators must prioritise the protection of consumers.

They should do so by setting out clear outcomes that consumers can expect from providers of legal services. The LSB does accept that on some occasions the regulatory objectives may be in tension. However, such tension is more easily resolved through a focus on the outcomes expected rather than rules which can never cover every conceivable eventuality.

7. To conduct this process the LSB has produced a self-assessment template (**annex A**) for each approved regulator complete. The template allows approved regulators to make an assessment of their level of performance for each constituent part of regulation and assess their capacity and capability. It requires evidence to support each assessment and allows approved regulators to detail any work they are currently undertaking or planning to undertake relevant to the constituent part of regulation or their capacity and capability.
8. To try to ensure the success of the self-assessment process the LSB expects significant regulatory Board involvement in the process. The Board as a whole will be expected review and approve the completed assessment before submission. We also expect lay board challenge throughout the process. The LSB strongly endorses the use of independent third party review before submission; such a review could be completed by an appropriate professional (such as an auditor), expert or consultant and could include individuals sitting on other legal services regulatory boards. If an approved regulator chooses not to submit their draft assessment to external scrutiny the LSB requires a clear signed statement as to why it was not done.
9. The LSB will also gather its own information on each approved regulator, and once the self-assessment has been submitted will critically appraise each submission.
10. A final assessment will be produced by the LSB and published alongside an agreed action plan for each regulator. The action plan will include details of work being carried out by each approved regulator and the milestones for completion.
11. The timeline for the next steps for self assessment is as follows:
  - December 2011 – Decision document published.
  - December 2011 to April 2012 – Draft self assessments completed by regulators.
  - May 2012 to June 2012 consideration of draft self assessments by LSB and feedback and discussion between LSB and the approved regulator.
  - July 2012– Final self-assessments submitted to the LSB by approved regulators.
  - August and September 2012 – Assessments and action plans published.

## Introduction

### What is the role of the Legal Services Board?

12. The LSB does not directly regulate legal services providers but instead has responsibility of regulatory oversight of the approved regulator. It is the approved regulators that have the role of regulating legal services providers across the different markets.
13. The LSB has set out its objectives and processes in previous consultations, rules and business plans. These combine reactive processes that meet our obligations to consider certain applications, proactive interventions that will support the regulatory objectives such as opening up the legal services market through allowing alternative business structures (**ABS**) and strategic interventions that provide a (more or less prescriptive) context for regulators to develop their own approaches to certain regulatory objectives such as diversity.
14. These different approaches come together in three areas of our work:
  - approving new approved regulators or licensing authorities
  - approving the extension of reserved activities regulated by any existing approved regulators or licensing authorities
  - approving new and amended regulatory arrangements
15. So far our approach has been evolutionary. We have set high level rules for processes which the Act requires and have focused these on outcomes rather than prescription where we consider it most appropriate. This has meant that approved regulators have had the freedom to design their own approaches to regulation which are compatible with the regulatory objectives and better regulation principles. Our evolutionary approach has been effective and we expect that it will continue. But evolution is built upon change and learning from experience.
16. We recognise that, like the wider legal profession, the approved regulators are diverse. It is not our intention to be prescriptive about how each approved regulator must regulate but in order to demonstrate that each is effective and is acting in a way that is compatible with the Act, we need to have a much better understanding of how they do regulate.

### Regulatory standards and the consultation process

17. In May 2011 we published a consultation paper entitled *Developing Regulatory Standards*. The paper discussed how the LSB will assess whether the regulatory standards and performance of the approved regulators are consistent with the regulatory objectives in the Act and that they act in a way

that is compatible with the better regulation principles and best regulatory practice.

18. To do so we consulted on what we consider are the constituent parts of good regulation and the standards and criteria against which we would assess the approved regulator's performance.
19. The constituent parts of good regulation are:
  - An outcomes-driven approach to regulation that gives the correct incentives for ethical behaviour and has effect right across the increasingly diverse market.
  - A robust understanding of the risks to consumers associated with legal practice and the ability to profile the regulated community according to the level of risk.
  - 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.
20. We also included in the consultation some criteria and indicators to assess the capability and capacity of the approved regulators. We consulted on for a 12 week period which ended on 12 July 2011. We received 10 written consultation responses. All responses have been published on our website.
21. This paper provides a summary of the range of the responses we received to the consultation. It also includes feedback received from a workshop held to discuss the proposals in more detail with the relevant regulators, and feedback from the Legal Services Consumer Panel. A full list of respondents is at **Annex B** (including a glossary of acronyms for each group). This paper also sets out in more detail the LSB's expectations and the rationale for regulatory standards and self-assessment requirements.

## General comments

22. The majority of respondents used the consultation paper to raise some broader points about the legal services regulatory framework, the role of the LSB and to comment generally on the proposals.
23. One of the main issues concerning the representative bodies and the BSB was whether the LSB has the power to set standards of regulation and to require approved regulators to assess their regulatory regime against those standards. The BSB argued that *“if it were envisaged that the Legal Services Board should undertake a primary role [in setting regulatory standards] then that [section 4 of the Act] would have been clearly stated as an obligation to act rather than an obligation to assist in the legislation”*. The Law Society argued that the LSB *“should act primarily as a safety net, leaving lead responsibility for regulation with the approved regulators and intervening only when they appeared to be failing”*.
24. Despite these questions, most respondents did broadly support the proposals detailed in the paper and the method of assessment. Indeed the SRA felt that each approved regulator should already have mechanism and improvement processes to ensure the effectiveness of their respective regulatory regime. It stated that all approved regulators should *“set themselves measurable objectives which seek to improve standards amongst their regulated community and help them meet the regulatory objectives”*.
25. ILEX and ILEX Professional Standards understood the proposal to mean that approved regulators had the freedom to design their own regulatory approach and then assess their chosen regime against the requisite standards. If the approach accorded with this understanding then they were broadly content with the proposals.
26. Despite this support a number of respondents did have concerns about the timescale envisaged in the consultation paper and there were worries that the LSB would impose a set regulatory approach that must be followed rather than allowing the freedom that some respondents felt the approach allowed. This was particularly pronounced on the issue of outcomes focused regulation. A couple of respondents argued that, despite supporting outcomes focused regulation where appropriate, it is not for the LSB to dictate that regulators adopt this approach.
27. The BSB said: *“The BSB expects that over time risk based regulation with a greater element of outcome focused regulation will indeed be the approach taken by all approved regulators. That being said, that change will happen incrementally as regulators introduce modifications to their regimes to meet specific needs. No regulator should be forced to prioritise modernisation solely for modernisation’s own sake, to the extent that this prejudices getting on with the job they have to do as regulators. Above all, the LSB itself should be taking an outcome focused and risk based approach to the front line regulators: that means allowing them to get on with the job, guided by the regulatory objectives*



*and principles, rather than prescribing how the job is to be done and only intervening where there is evidence of a need to do so”.*

28. The final issue raised by respondents, which to a certain extent contradicts some of the issues discussed above, is the issue of ‘regulatory competition’. Broadly this means the situation where a number of different Approved Regulators are able to regulate similar or the same activities and individuals or entities. A number of respondents consider that such competition provides incentives for legal services providers to seek regulation from the regulator perceived to place the least requirements on them, and for regulators to design regimes that focus on attracting firms rather than protecting consumers from unacceptable risks. Opponents consider that it will also lead to inconsistencies and confusion across the legal services market. Manchester Law Society says: *“The regulatory approach must be consistent across all regulators; ‘regulator shopping’ should not be an option for firms looking to take the easy option”.*

### **LSB response**

29. We consider that we must be able to assure ourselves that the approved regulators are carrying out their functions in ways that are compatible with the statutory requirements in the Act and that they are not allowing, or risking, unacceptable consumer detriment in the markets they regulate. In addition, the requirement on the LSB and the Approved Regulators to have regard to the principles of better regulation and best regulatory practice (section 3 and 28 of the Act) provides a firm basis for setting out our view of appropriate regulatory standards for legal services regulation.
30. The requirement to have regard to *‘best regulatory practice’* implies a continuing evolution of how ARs regulate; regulating in a way more efficient for those regulated but still protecting consumers from detriment. This work draws heavily on the latest thinking to set out a modern approach to the regulation of legal services providers.
31. Section 3 and 28 of the Act requires that all approved regulators and the LSB act in a manner compatible with the regulatory objectives. In order to act in a way that is compatible with the regulatory objectives the LSB must assure itself that approved regulators are protecting the interests of consumers (regulatory objective 4), ensuring that authorised people adhere to the professional principles<sup>1</sup> (regulatory objective 8) and that the public interest is protected (regulatory objective 1). There can be no doubt that the language of the Act – “protecting”, “promoting”, “improving” in the regulatory objectives - requires the LSB to be proactive in this respect.
32. We consider that the Act places a positive (not a passive or purely responsive) responsibility on the LSB: *“The Board **must** [emphasis added] assist in the*

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<sup>1</sup> The profession principles include that authorised persons; act with independence and integrity; that proper standards of work are maintained; act in the best interests of the client; comply with their duty to the court; and, maintain client confidentiality.

*maintenance and development of standards in relation to, (a) the regulation by approved regulators of persons authorised".* Therefore, we need to be satisfied that approved regulators are effective regulators which operate in a way that is consistent with the better regulation principles. We do not agree, as has been suggested, that this means that we only assist where an approved regulator asks or agrees that such assistance is needed.

33. On the regulatory competition matter, currently there is actually only one regulator with an exclusive jurisdiction over a specific reserved legal activity: the Master of Faculties is the sole regulator of Notarial Activities. All of the other reserved legal activities can be regulated by more than one approved regulator. Furthermore the Act not only allows existing approved regulators to apply to extend the reserved legal activities they are able to regulate, but also allows new organisations to become approved regulators and so regulate reserved legal activities.
34. These facts have helped influence the LSB's approach to developing a framework to evaluate regulatory standards. We recognise that with competing approved regulators there is a risk that they may seek to compete against each other to attract legal services providers at the expense of exposing consumers to unacceptable levels of will risks which will result in adverse impacts on the regulatory objectives. We consider that it is the LSB's role to ensure that appropriate regulatory standards are maintained across the legal services market and that these risks do not crystallise.
35. We have focused on maintaining these standards through our regulatory decisions process which requires approved regulators to explain what impact a proposed change in regulatory arrangements will have on the regulatory objectives. In addition we have made rules requiring appropriate arrangements to be in place before an organisation can become an Approved Regulator and / or when an Approved Regulator seeks an extension to the reserved legal activities they regulate. We have also made similar rules for Approved Regulators seeking to become a Licensing Authority. We have used these rules processes to conduct detailed scrutiny of each application to ensure that the regulatory objectives, and in particular the interests of consumers – whoever they may be – are not subject to an unacceptable level of risk of adverse outcomes.
36. These regulatory decision processes have been effective at ensuring that Approved Regulators' regulatory arrangements are compliant with the requirements to act in a way that is compatible with the regulatory objectives. However, there is a risk arising from the fact that these decisions only consider the regulatory regime in parts rather than as a whole. This is because we can only consider the changes to arrangements or the arrangements related to an application when they are presented to the LSB for consideration. The processes also do not examine in detail the operation of the regulatory arrangements in practice and the interaction of each regulator's different arrangements.
37. This is why the consultation document stressed the importance of looking at the constituent parts of regulation as part of a jigsaw and that, without each piece,

the regulatory regime may not be able to protect consumers appropriately and there may be adverse impacts on the regulatory objectives.

38. The comments regarding timeline and the role of outcomes focused regulation are covered in detail in our response to questions 2 and 5.

## Changing context for legal services and thus regulation

### Question 1

Do you agree with our analysis of the changing legal services market? Are there other factors that should be taken into consideration?

39. Comments from respondents largely supported or added to our analysis of the changing legal market. Only one respondent felt that the advent of alternative business structures (ABS) would not lead to changes in the legal services market. The respondent in question noted that the creation of Licensed Conveyancers and the extension of the reserved powers granted to Legal Executives in recent years had not led to dramatic changes in the legal services market. Therefore, they argued, there is no reason to suspect that the liberalisation of legal services that ABS brings will lead to widespread market change.
40. Additional areas that respondents suggested would have an impact on the changing legal services market included:
  - The impact of the broadening of the areas that existing regulators regulate and / or the entry of new legal services regulators.
  - The development of niche and multi disciplinary firms providing a range of services to businesses, other professionals as well as direct to consumers.
  - The impact of the recent recession and continued economic uncertainty.
  - The increasingly sophisticated roles being played by in-house / employed legal staff.
  - Technological developments and changes in service offering.
  - Competition between regulated and unregulated legal services providers.
41. The analysis was also criticised by a respondent for its relative lack of empirical evidence. They considered that it appeared that only an economic approach was used to look at the likely future development of the legal services market. They argued that it would be appropriate to look at the strong professional obligations that will apply in the changed context.

## LSB response

42. The LSB has published extensive research looking at the current shape of the legal services market, considering the future legal services market and the impact of the introduction ABS. For example:
- LSB (August 2011), *Research Note – The Legal Services Market*<sup>2</sup>
  - LSB (June 2010), *The Future of Legal Services: A compendium of essays on the future landscape of the sector*<sup>3</sup>
  - Oxera (September 2011), *A framework to monitor the legal services sector*<sup>4</sup>
  - CRA (August 2011), *Benchmarking the supply of legal services by city law firms*.<sup>5</sup>
43. In addition to these documents, and our other commissioned research reports, the LSB has collected a database of 614 different research reports into the legal service market. We have also created a data platform using 20 different data sets to model the legal services market over time and to better understand the relationship between demand and supply of legal services. This will be published in due course.
44. This array of research supports our central thesis that the market has changed and will continue to change. This change has led to shifts in the risks faced by the public and consumers. Regulation must be responsive to deal with these continued changes. Regulation at its best can support, encourage such change to ensure that the regulatory objectives are not undermined and consumers are protected from unacceptable levels of risk.
45. Of the additional factors cited by respondents as influencing change we agree that each of them has the potential to influence the direction of the legal services market over the next few years. Many of those factors were detailed in the LSB's research note<sup>6</sup> but simply not reflected in the paper. However, when making recommendations we have drawn on all available data to form a reasonable view on the likely developments in the legal services market over the next few years.

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<sup>2</sup> LSB (August 2011), *Research Note – The Legal Services Market*, London.

<[http://www.legalservicesboard.org.uk/news\\_publications/latest\\_news/pdf/research\\_note\\_on\\_the\\_legal\\_services\\_market.pdf](http://www.legalservicesboard.org.uk/news_publications/latest_news/pdf/research_note_on_the_legal_services_market.pdf)> Accessed December 2011

<sup>3</sup> LSB (June 2010), *The Future of Legal Services: A compendium of essays on the future landscape of the sector*, London.

<[http://www.legalservicesboard.org.uk/what\\_we\\_do/Research/Publications/the\\_future\\_of\\_legal\\_services.htm](http://www.legalservicesboard.org.uk/what_we_do/Research/Publications/the_future_of_legal_services.htm)> Accessed December 2011

<sup>4</sup> Oxera (September 2011), *A framework to monitor the legal services sector*, London.

<[http://www.legalservicesboard.org.uk/news\\_publications/latest\\_news/pdf/a\\_framework\\_to\\_monitor\\_the\\_legal\\_services\\_sector.pdf](http://www.legalservicesboard.org.uk/news_publications/latest_news/pdf/a_framework_to_monitor_the_legal_services_sector.pdf)> Accessed December 2011

<sup>5</sup> CRA (August 2011), *Benchmarking the supply of legal services by city law firms*. London.

<[http://www.legalservicesboard.org.uk/news\\_publications/latest\\_news/pdf/benchmarking\\_city\\_law\\_firms\\_final\\_report\\_v3.pdf](http://www.legalservicesboard.org.uk/news_publications/latest_news/pdf/benchmarking_city_law_firms_final_report_v3.pdf)> Accessed December 2011

<sup>6</sup> LSB (August 2011), *Research Note – The Legal Services Market*, London

<[http://www.legalservicesboard.org.uk/news\\_publications/latest\\_news/pdf/research\\_note\\_on\\_the\\_legal\\_services\\_market.pdf](http://www.legalservicesboard.org.uk/news_publications/latest_news/pdf/research_note_on_the_legal_services_market.pdf)> Accessed December 2011

## What sort of regulation does the LSB expect from ARs?

### Question 2

Do you agree with our focus on outcomes focused regulation, risk identification framework, proportionate supervision and appropriate enforcement strategy?

46. The vast majority of respondents agreed with the four constituent parts of regulation identified in the consultation paper.
47. The Law Society stated that *“all the areas mentioned in the question are important components of any regulatory structure; thus the Society agrees it is understandable for the LSB to wish to consider how legal regulators perform in these different areas”*. Most other respondents echoed this sentiment. A number of respondents, particularly the CLC, felt that the focus on the four constituent parts neglected the role that good entry requirements and / or authorisation regimes play in ensuring the regulatory community are able to deliver legal services that meet the regulatory objectives.
48. Some respondents queried the extent to which there should be flexibility within the constituent parts of regulation. The SRA felt that it was necessary for the LSB to adopt a more flexible approach to allow regulators to deliver the needed improvements for users of legal services. The BSB also argued that outcomes focused regulation should have the flexibility to allow prescription where necessary. In addition the BSB felt that the emphasis on the consumer was at the expense of the other regulatory objectives, and on occasion the interest of consumers may be in tension with other regulatory objectives. In its response the BSB stated that *“prioritising the consumer and their expectations may not be appropriate if the duty to the court, the rule of law or access to justice is going to be unacceptably compromised as a result. It is for the frontline regulators to strike a balance between competing regulatory objectives, in such cases”*. Conversely others suggested that the danger of allowing too much flexibility is that inconsistencies embed themselves into the legal services regulatory system. They consider that inconsistency may exacerbate consumer confusion.
49. Two respondents felt that adopting an outcomes focused approach was beyond what was expected during the passage of the Act. The Law Society went so far as to argue that it is unjustifiable of the LSB to conclude that the better regulation principles can only be met through outcomes focused regulation, and the LSB imposing such approach would not be proportionate.
50. ILEX and ILEX Professional Standards in their joint response said that it was important to note the issues that have occurred in financial services regulation over the last few years. They suggested that outcomes focused regulation in the financial services market allowed firms to *“get away with the minimum level of conduct possible and therefore providing inadequate protection to consumers”*.

## LSB response

51. We agree with respondents that the constituent parts of regulation are fundamental components of the legal services regulatory regime. We consider that the four constituent parts form a virtuous circle of best regulatory practice, with each aspect feeding back into each other. For example a regulator's risk assessment supports its supervision policy, supervision may lead to enforcement and during enforcement it may identify need to change its risk assessment policy, its supervision policy and even alter its regulatory arrangements.
52. During the passage of the legislation, and in LSB publications, the Government and LSB have made it clear that there is not a hierarchy of regulatory objectives. We have stated that in some areas of work particular regulatory objectives will be more prominent. Our business plan identified four regulatory objectives that this work was specifically relevant for:
- RO1: Protecting and promoting the public interest
  - RO4: Protecting and promoting the interests of consumers
  - RO6: Encouraging an independent, strong, diverse and effective legal profession
  - RO7: Increasing understanding of the citizen's rights and duties
53. That is not to say that we do not consider that the other regulatory objectives are not relevant. Indeed we would argue that all of the regulatory objectives can and will be supported by this project. The provision of independent and effective regulation will promote and maintain adherence by authorised persons to the professional principles. It will support the rule of law by ensuring that legal regulation is accessible, intelligible, clear and predictable and that enforcement procedures are timely and fair. The project will drive competition by encouraging approved regulators to have arrangements that are flexible enough to allow innovation by providers without reducing consumer protection. The project will assist in improving access to justice by fostering consumer confidence in the providers of legal services.
54. On the issue of whether it is appropriate to expect outcomes focused regulation, we do not agree that such an approach will necessarily prioritise the interests of consumers above the rule of law and a lawyer's duty to the court. We agree with the views of a regulator at our workshop on the issue, who said that outcomes focused regulation allows authorised persons to use their professional judgements to deliver the right outcomes across the board. It is for authorised persons to prove that they have the right systems and processes in place for making such decisions and that they can justify each decision taken. This does not preclude *bright line* rules where they are the only realistic way of ensuring the necessary standards are met, particularly by individual practitioners, but in most cases there is no reason to prescribe only one way of achieving an objective. This is especially the case when looking at entity level.

55. However, we also consider that one of the primary purposes of regulation in the legal services market is to protect the public and consumers from unacceptable levels of risk. This means that we expect the public and consumers to be at the heart of regulatory policy making and that the approved regulators have regulatory arrangements that can and do deliver appropriate protection for the public and consumers.
56. We also do not accept the premise that the recent financial crises have wholly discredited outcomes focused regulation. Various papers and speeches on the subject have suggested that the problems were linked to a failure to appreciate system wide risks and the high level of interconnectedness between different market participants in the financial services market. As the speech by the Chief Executive of FSA in March 2010 made clear, since the financial crisis the FSA has moved from an approach often described principles based regulation to one that is *outcome-based* delivered through intensive supervision. As he noted: *“The new outcomes-based approach, however, is centred on intervening in a proactive way, and judging the future decisions of firms based on business model and other analysis”*.<sup>7</sup>
57. The recent FSA Board report into the failure of the Royal Bank of Scotland<sup>8</sup> explores the issues surrounding the failure of said bank. It does not conclude that the operation of principles-based or outcomes-focused regulation was the root cause of the deficiencies in regulatory approach they identify. Page 258 of the review identifies a number of the deficiencies in approach and structure that contributed to the inability of the FSA to spot the emerging prudential risks. The deficiencies in approach detailed included a reliance on a relatively high-level risk assessment of the key issues affecting a high impact firm, an overly reactive approach to supervision, which placed an undue reliance on assurances from firms’ management and systems, and the failure of supervisors to be required to question business strategies and reach their own judgement.
58. In response to these deficiencies the review states that *“FSA’s supervisory approach for high impact firms has changed significantly, including through the implementation of the SEP [Supervisory Enhancement Programme]. The more proactive, intensive and intrusive manner, and ‘outcomes focused’ style of supervision, has been enabled by significantly increased resources, in particular in the numbers of specialists.”*<sup>9</sup> We recognise that the legal services market is different from the financial services market, however we consider that such conclusions are in keeping with the constituent parts of regulation we have identified.
59. We also consider that all the constituent parts of regulation represent best regulatory practice both domestically and internationally. The OECD’s recent

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<sup>7</sup> Sants (March 2010), “UK Financial Regulation: After the Crisis”, *Annual Lubbock Lecture in Management Studies 2010*, London <[http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2010/0312\\_hs.shtml](http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2010/0312_hs.shtml)> Accessed December 2011.

<sup>8</sup> FSA (December 2011), *The Failure of the Royal Bank of Scotland: Financial Services Authority Board Report*, London, <<http://www.fsa.gov.uk/pubs/other/rbs.pdf>> Accessed December 2011.

<sup>9</sup> Page 286, FSA (December 2011), *The Failure of the Royal Bank of Scotland: Financial Services Authority Board Report*, London, <<http://www.fsa.gov.uk/pubs/other/rbs.pdf>> Accessed December 2011.



consultation on regulatory policy and governance – which builds on existing OECD instruments on regulatory reform since 1995 – sets out a series of recommendations relating to regulatory quality.<sup>10</sup> These recommendations include:

- Orienting regulatory policy around the needs of users (consumers).
- Establishing institutions and mechanisms to actively pursue the oversight of regulatory policy procedures and goals that support and implement regulatory policy and foster regulatory quality.
- To apply risk assessment, risk management and risk communication strategies to the design and implementation of regulations.
- To ensure that regulation is targeted and effective – regulators should also assess how regulations will be given effect and should design responsive implementation and enforcement strategies.

60. The four constituent parts of regulation are in line with current Government's regulatory policy. We will continue to liaise with officials at the Better Regulation Executive in developing our approach. The current Government's regulatory strategy is to:

- *remove or simplify existing regulations that unnecessarily impede growth*
- *reduce the overall volume of new regulation by introducing regulation only as a last resort*
- *improve the quality of any remaining new regulation*
- *move to less onerous and less bureaucratic enforcement regimes where inspections are targeted and risk-based.*<sup>11</sup>

61. In addition, the Better Regulation Executive has recently consulted on a review of regulatory enforcement entitled *Transforming Regulatory Enforcement: Freeing up Business Growth*. The document set out the Better Regulation Executive's new approach to regulatory enforcement policy and encouraging consistency across regulators. Building on the Hampton Principles it proposed to embed additional principles governing regulatory enforcement matters. The proposed principles are: (1) greater accountability; (2) recognising and promoting best practice; (3) greater transparency. The work includes checks that regulators have properly embraced the principles of the Regulators' Compliance Code. It also plans to review, sector by sector, whether each existing regulator is delivering regulation in the most effective manner.

62. Considering this policy landscape, and alongside other academic work on regulatory policy,<sup>12</sup> suggests that there should be a presumption in favour of

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<sup>10</sup> OECD (2011), *Draft Recommendation on Regulatory Policy and Governance*, Paris. <<http://www.oecd.org/dataoecd/49/43/48087250.pdf>> Accessed December 2011

<sup>11</sup> Statement of the Government's better regulation strategy taken from the Department of Business, Innovation and Skills website <<http://www.bis.gov.uk/bre>> accessed December 2011

outcomes focused regulation alongside the rest of the constituent parts of regulation. However, we do accept that there may be some instances when very specific rules may be the only realistic way to guarantee that desired outcomes are delivered. However it is for regulators to justify with evidence why they impose rules rather than use outcomes.

63. We will not compel regulators to move instantly to an outcomes focused approach. But we will expect regulators to have a clear plan on how they intend to develop their regulatory arrangements so that they will accord with best regulatory practice, as required by the Act. We also believe that, even in the presence of 'bright line' rules, regulators must have an understanding about why they impose each rule and what outcome they are trying to achieve and whether they are achieving that outcome.

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<sup>12</sup> See Sparrow (2008), *The Character of Harms*, Cambridge University Press, London, R. Baldwin and J. Black (2010), "Really Responsive Risk-Based Regulation", *Law and Policy* 32 (2) 2010, pp.181-213 and J Black (2008), "Forms and paradoxes of principles-based regulation", *Capital Markets Law Journal* (2008) 3(4): pp. 425-457.

### Question 3

How do you think that a more flexible and responsive regulatory regime should be developed?

64. ILEX and ILEX Professional Standards argued in their joint response that the regulatory regime for legal services needs to be more proactive and forward thinking, rather than response and passive. They consider that each regulator should develop a regulatory approach that is “*consistent and tailored to its respective regulated community*”. They stated that “*we are firmly of the view that such an approach will lead to significantly higher standards of professional conduct and competence than the prescriptive and confrontational regime that can be superficially attractive*”. The Law Society expressed more caution by arguing that such factors should not be looked at in isolation from other factors like security, confidence, public interest or understanding the market within which rules operate.
65. The CLC argued that only by effective implementation of all the constituent parts of regulation as well as outcomes focused regulation will a more flexible and responsive regulatory regime emerge.
66. The SRA felt that the LSB should encourage regulators to “*develop their own systems of improvement and review, targeted at improving firstly the greatest needs within their regulated community and secondly their own internal effectiveness; both of which should be targeted at the regulatory objectives. Discretion in the delivery for ARs will result in a flexible and responsive regulatory regime*”.
67. The BSB noted that with regulatory change comes costs on practitioners and, therefore, ultimately consumers. At a time of significant change in the market the BSB felt that regulators should not be compelled to make changes unless there is a clearly evidenced need.

### LSB response

68. The LSB agrees with the CLC’s view that only with the effective implementation of all of the constituent parts of regulation will a more flexible and responsive regulatory framework for legal services emerge. One of the drivers for delivering this ideal regulatory regime is the creation of the regulatory standards to be applied across the legal services market. The regulatory standards detailed are derived from the regulatory objectives, better regulation principles and best regulatory practice, and each approved regulator must meet them. However, by using standards the LSB will not dictate exactly how an approved regulator must meet that standard. We will expect each approved regulator to explain with evidence how its arrangements meet the standards. Such an approach, with outcomes focused regulation at its heart, will lead to higher standards of professional conduct and competence.

69. Involving approved regulators in this approach will enable them to link their own systems of improvement and review to the LSB's regulatory standards assessment and review. They will then be able to target their work at improving the areas of greatest priority for the protection of consumers and the wider regulatory objectives.
70. We recognise that regulatory change does impose a cost on practitioners, which is ultimately borne by consumers. However we would also argue that regulations that fail to respond to changing circumstances and technological change also imposes a cost on practitioners and consumers.
71. The OECD recommendations on regulatory policy suggests that regulators should *“conduct systematic programme reviews of the stock of regulation against clearly defined policy goals, including consideration of costs and benefits, to ensure that regulations is necessary and how it can be most effective in achieving those goals”*.<sup>13</sup>
72. We would expect each regulator to schedule reviews of their existing regulations against the regulatory standards expected. We also would argue that a shift to outcomes focused regulation will reduce the need for continuing changes to regulatory arrangements.

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<sup>13</sup> OECD (2011), *Draft Recommendation on Regulatory Policy and Governance*, OECD Paris. <<http://www.oecd.org/dataoecd/49/43/48087250.pdf>> Accessed December 2011

## Implementation

### Question 4

We would welcome views on whether self-assessment is an appropriate approach or whether LSB should deliver its oversight by conducting its own reviews

73. All the regulators that responded favoured a self-assessment process in the first instance. They argued that it was in keeping with the LSB's other regulatory approaches. Their view was that providing the template is not overly burdensome most felt the exercise would be useful for their development. As the SRA noted, self assessment would give it the *"responsibility and accountability for our own improvement"*.
74. ILEX and ILEX Professional Standards did feel that any further work arising from the self-assessment process, such as action plans for regulatory improvement and / or thematic reviews conducted by the LSB could be intrusive and burdensome. They argued that the LSB should consider the burden they are placing on regulators. They also queried the regularity of such self-assessments and thematic work.
75. The Legal Services Consumer Panel, and to a certain extent the Legal Ombudsman, were not as confident in the concept of self-assessment as the regulators. The Legal Ombudsman noted that a self-assessment process, by its nature, can lack consistency. It also worried that the regulators may not necessarily have the skills, resources and ability to deliver within the framework set out. The Legal Services Consumer Panel questioned whether we could be confident that regulators will be fully honest or challenging in appraising themselves. To reduce this risk suggested that, to give the exercise senior leadership and credibility, the reviews should be led by members of regulatory boards. Additionally it felt that a stronger emphasis on external peer review would be welcome and that this should be an expectation of the process, divergence from which would need to be justified.
76. The Legal Services Consumer Panel's final point was whether the LSB is confident that it has the expertise to assess what good practice looks like across the full set of indicators and all of the regulators.

### LSB response

77. The LSB has carefully considered the benefits and costs of adopting the self-assessment approach and we have reviewed the oversight approach of existing oversight regulators. A summary of the oversight approach of the Council for Healthcare Regulatory Excellence and the Professional Oversight Board of the Financial Reporting Council can be found in boxes 1 and 2.

### **Box 1: Council for Healthcare Regulatory Excellence (CHRE)**

#### *Summary of Approach*

The CHRE operates as an oversight regulator, supervising the nine health professions regulators. Specifically, the CHRE has a statutory obligation to report annually on the regulators' performance.

CHRE's annual Performance Review is laid before Parliament and the devolved governments in June each year. It contains a detailed assessment of each regulator's performance against the standards set by CHRE in relation to the regulators' four key statutory functions: standards and guidance; education and training; registration; and fitness to practise.

Regulators are required to submit outcome-focused evidence of how they have met the standards set by CHRE in relation to each standard. CHRE staff carry out a desk-based review of the evidence provided by the regulators as well as feedback received from third party stakeholders (including feedback received specifically in relation to the performance review, but also thematic issues raised during the course of the year by those wishing to complain about the regulators). CHRE staff then meet with the senior management within each individual regulator, before finalising their assessment of that regulator's performance.

#### *Resource commitment*

The CHRE comprises 19 people and an independent lay board. Six people work full-time in the Scrutiny & Quality team that is responsible for the Performance Review process. The Performance Review process takes up a significant proportion of that team's time, particularly during the period from December – April each year. Issues that arise from analysis of the evidence submitted to the Performance Review may also lead to the identification of areas for future policy work by CHRE.

#### *Timescales*

All timescales are driven by the statutory obligation to publish the Performance Review report, which is laid before Parliament and the devolved governments before their summer recess. The Performance Review process begins in October each year when CHRE send out the evidence template (a form of self-assessment) – which the regulators are required to complete and return by December. Analysis and testing of the evidence provided, together with additional questioning of the regulators then takes place, before the report is drafted and circulated to the regulators for comments in April/May, before being finalised for publication.

## **Box 2: Financial Reporting Council (FRC)**

### *Summary of approach*

The FRC's professional oversight board operates as an oversight regulator of the auditing and actuarial profession by the Recognised Qualifying and Recognised Supervisory bodies and the actuarial bodies. Most of the FRC's powers are derived from statutory powers (e.g. Companies Act 2006) delegated directly, or from statutory obligations on other parties to meet requirements set by the FRC. The Actuarial arrangement is a voluntary one following the Morrison Report into Actuarial Standards.

The FRC's strategy towards regulation is a principles-based approach. The practical implementation of this is through inspection, with staff sent on-site to regulators.

The approach taken by the FRC is broken down into several areas: professional standards including disciplinary arrangements; professional qualifications which include entry requirements; and complaints handling. The FRC focuses on information gathering such as mapping processes within regulators and also for the identification of risks and possible weaknesses in procedures.

Private reports on these visits are sent to the Bodies with the main points being reported annually to the secretary of state in a report which is published. In that document, key findings and recommendations from the oversight process are made public, and the scope and coverage of regulatory inspections commented on. The threat of publication of a refusal to explain why recommendations are being ignored acts as a method of shaping behaviour. If any thematic problems arise, the FRC has the capacity to follow this up with more in-depth reviews.

By sending FRC staff on inspection visits to regulators the accuracy of the assessment has been improved as well as the evidence base for its regulatory decisions.

### *Resource commitment*

FRC staff spend a week with each supervisory and qualifying body reviewing a pre-selected area and running through progress on previous recommendations made. During which the FRC can gather detail on regulators' procedures for meeting their statutory requirements under the Companies Act.

The Bodies are required to submit an annual return which contains information to help the FRC inform which areas to concentrate on in their annual reviews. They also use many sources of information for selecting our areas of review, including complaints and general issues arising in the financial press.

In order to complete the inspections there are about 1.5 people per year working full time on assessment and oversight. The regulatory assessment unit at the FRC in total comprises around 4.5 people who collectively undertake oversight activities and the regulation of audit.

A further 20 people work in the audit inspection unit (AIU) which reviews public interest audits. Thematic issues identified by this unit may be taken up by the FRC for further investigation. This approach provides the FRC with scope to pin-point certain issues and look across all areas of the regulators' operations, rather than remaining too predictable.

### *Timescales*

The oversight process is undertaken on an annual basis. The process of oversight is typically several months in length and includes a staff member being in situ with each of the RSBs and RQB's being assessed. Although this can vary from depending on the area being reviewed and the FRC's perception of the degree of risk at each body.

78. In addition to reviewing two comparable oversight regulators we also reviewed the approach to reviewing regulators undertaken as part of the Hampton review process during 2008 undertaken by the Better Regulation Executive with the

National Audit Office. Our analysis of the different approaches suggests that there are number of success factors that lead to good quality assessments of regulators. This includes:

- senior management buy in from those being assessed
- appropriate governance processes
- evidence used to support the assessment
- external challenge and evidence based challenge from the assessor.

79. Following these reviews and considering the comments from respondents, we remain of the opinion that self-assessment remains the most appropriate approach. However, in order to capitalise on the success factors identified from other approaches and mitigate some of the risks inherent within self-assessment we will be introducing a number of requirements to strengthen the proposal. These are:

*Regulatory board approval*

80. We will require the Chair of each regulatory board to sign the completed self-assessment form on behalf of the regulatory board. We will expect the whole regulatory board to review and approve the final submission at a formal meeting.

*Regulatory board member involvement*

81. We expect that there will be significant lay board member involvement and challenge throughout the self-assessment process. We favour the use of a lay member to avoid any inadvertent professional bias and / or the appearance of such bias. We expect that the board member will act as challenge to executive staff to help ensure that all information contained within the response is accurate and represents a fair and reasonable assessment.

*Independent third party review*

82. The LSB expects that each regulator either subjects their completed self-assessment to independent scrutiny or explains why they have chosen not to. The independent scrutiny can be completed by an appropriate professional, expert or consultant. This could include individuals sitting on other legal services regulatory boards, however they should not be current or previous members of the regulatory board under consideration. This individual must provide their contact details, any professional accreditation and signature on the submitted self-assessment.

83. The purpose of the third party review is to assess whether the regulatory board and its executive have followed appropriate procedure, including the use of evidence, to make the judgements contained within the self-assessment and in any other documents submitted alongside the assessment.



### *Meeting*

84. Once the self-assessment is completed and submitted in draft, the LSB will review the document and hold a meeting with representatives from the approved regulator. The purpose of the meeting will be to explore the draft assessment and action plans and discuss any issues raised by the submission. The LSB will collate information received from its wider work and use that information as it relates to the regulatory standards project. This could, for example, include correspondence from members of the public, findings from thematic reviews such as our complaints handling review and reviews of other published material.

### *Finalisation and publication*

85. Once the LSB has provided feedback, the approved regulator will finalise the self-assessment and action plan. It will be submitted in final form after the approved regulator's board has considered it. The LSB will publish a summary of the self-assessment, details of the action plan and any remaining areas of concern that have not been incorporated into the self-assessment or action plan.

## What do ARs gain from this approach? What are the risks to ARs in undertaking the changes to become modern regulators?

### Question 5

What benefits, costs and risks to ARs and their regulated communities are we missing?

86. Most of the respondents felt that a process of review and improvement within regulators will benefit the regulators, the regulated community and ultimately the users of legal services. As the CLC noted *“we believe the proposals will promote each AR’s self-awareness and accountability, allowing it to benchmark its approach against its own objectives and those set out in the LSA. The actions to improve the regulatory approach which stem from that self-assessment will benefit both the AR and the regulated community. The cost of such action will obviously be dependent upon the issue raised and the mitigation needed as a result”*.
87. The biggest risks identified by approved regulators concerned the timeline envisaged in the consultation paper, the pace of changes demanded by the LSB and the short term costs of change. The Law Society also noted that there was a risk from focusing on the economic aspects rather than assessing the performance of approved regulators against the broader public policy requirements in the Act. ILEX and ILEX Professional Standards also noted that there was a risk of the LSB dictating how regulators should meet the relevant outcomes and principles of good regulation.
88. The Legal Ombudsman response looked across the whole legal services market when considering our proposals rather than the specific mechanics of the regulators and the interests of the profession. It noted that the benefits of getting regulation right are:
- increased consumer choice and confidence
  - a consistent regulatory approach across the different sectors of the legal profession
  - a less intrusive regulatory style for practitioners
  - flexibility for regulators to develop in their own way - within appropriate parameters - so a regulator can choose how to deploy resources effectively and meet the standards necessary.
89. The Legal Ombudsman noted that this exercise is not without costs and these may be borne by the end consumer. In terms of risks it felt some of the main issues were the risk that the regulatory standards work leads to no obvious change or improvement – especially to consumers. Additionally it felt that the proposals do not necessarily resolve the risk arising from firms continuing to find ways of remaining on the edges of regulation even if there is of a more widespread adoption of outcome focused regulatory arrangements.

## **LSB response**

90. The Legal Ombudsman set out a detailed list of benefits, costs and risks that we also recognise as possible outcomes. We do consider that the benefits of delivering a regulatory regime that meets appropriate standards will help support a legal services market that meets the needs of consumers. A market with increased consumer choice and confidence, innovative practitioners who, if posing few risks, are not subject to intrusive or inflexible regulation. It should also introduce a level of consistency in the approach to the regulation of legal service.
91. As we have said in our responses to other questions, we will not be inflexible in our interpretation of regulatory standards. However, we will challenge approved regulators that opt for regulatory approaches that are inconsistent with existing best practice and theory. We have also set out how, while the interests of consumers are paramount for this exercise, the other regulatory objectives have a role to play.
92. We have expanded our schedule to provide regulators more time to complete the self assessment process. Our revised timeline is as follows:
- December 2011 – Decision document published.
  - December 2011 to April 2012 – Draft self assessments completed by regulators.
  - May 2012 to June 2012 consideration of draft self assessments by LSB and feedback and discussion between LSB and the approved regulator.
  - July 2012– Final self-assessments submitted to the LSB by approved regulators.
  - August and September 2012 – Assessments and action plans published.

## Question 6

We would particularly welcome feedback on the criteria against to which assess ARs, including suggestions on others that might be appropriate.

93. The SRA noted in its response that there was a danger of adding more or extensive criteria. It considers that further extension may place undue pressure on a regulator to assess their performance in areas which may not be one of their regulatory priorities. It felt that a clearer focus may be beneficial.

## *LSB response*

94. The LSB has built a revised self-assessment template that takes on board the comments received to the consultation and those made during the workshop we held with the approved regulators.
95. The LSB's final position is that the indicators and key criteria (see box 3 on page 26) are still relevant. However, we will not ask approved regulators to assess themselves against each of the indicators or key criteria. Instead approved regulators will assess themselves against each of the four constituent parts of regulation and assess their capacity and capability. This simpler approach to assessment enables approved regulators to explain, with evidence, how their approach delivers each constituent part of regulation in a reasonably practicable manner.
96. We have provided a series of indicators for each constituent part of regulation of what we would expect an approved regulator to be doing if it is achieving an appropriate standard. We have also provided a number of factors that would indicate that an approved regulator is not achieving the appropriate standards. The self assessment template with these examples can be found at **annex B**.
97. The benefit of this change is to enable approved regulators to have a clearer focus on what standard the LSB is expecting. We will remain available to discuss interpretation with regulators.

**Box 3: Originally annex A in the Developing Regulatory Standards consultation paper.**  
Below is the annex that originally appeared in the consultation paper. It is repeated here for reference.

### **Key indicators of, or criteria for, regulatory standards**

#### **Outcomes-focused regulation**

- Outcomes that consumers should experience are the basis of codes of conduct and behaviour of authorised persons.
- Recognises the public interest in legal services as part of the wider justice system.
- Guidance is clearly discretionary and does not unnecessarily restrict firms in how they deliver the outcomes.
- Education and training standards (both at entry and on an ongoing basis) ensure that appropriate standards are achieved and maintained, and encourage diversity in the profession.
- Effective advisory services for regulated entities and individuals.

#### **Risk assessment**

- Focus on entity as well as individuals.
- Formalised approach to risk assessment which is transparent.
- Responsive to changing conditions.
- Collection of data set and other information to determine the risk assessment.
- Should be capable of picking up individual and firm specific issues as well as wider profession issues.
- Forward looking as well as assessing risks from current data.
- Outputs determine supervision activity – themes, intensity, frequency and form.

#### **Supervision**

- Activity determined by risk assessment outputs.
- Proactive as well as reactive.
- Forward looking plan of activity – focused on risks; flexible; reports produced on the progress against the plan, the findings and issues
- Responsive to changing conditions.
- Thematic as well as firm specific.

#### **Enforcement**

- Predominantly targeted at breaches that are serious and undermine the regulatory objectives (perhaps alongside a set of more administrative penalties).
- Incentivises and encourages compliance.
- Fast and fair.
- Deterrent as well a punishment.
- Appeals process.
- Publicity (important for deterrence).
- Enforcement policy that sets out the approach.

#### **Capacity and capability of ARs to deliver regulatory excellence**

- Clear understanding of the different areas that the regulator is responsible for.
- Number of people needed – maybe linked to the number of people / firms to be supervised; do they have enough for what they need to do?
- Type of people – skill sets; role profiles.
- Underlying governance processes, systems and controls – how will they deliver the various functions; do they know what they need to do; (independent) assessment of effectiveness; compliance with IGRs; clear mechanisms for consumer engagement in policy making processes.
- Effective Board, challenging and holding Executive to account, whilst defending regulatory independence.

## Outcomes focused regulation

98. The CLC and the BSB felt that the outcomes sought must be compatible with the Act's regulatory objectives. The BSB clearly stated that the focus should be on ensuring that all codes of conduct and behaviour of authorised persons reflect or support all of the regulatory objectives, not just the consumer experience. The Legal Services Consumer Panel felt that this constituent part of regulation should have an emphasis on how the regulator translates the regulatory objectives into a consumer-focused vision and set of priorities. It also felt that it was important that guidance is discretionary, noting that the benefits to practitioners and consumers of a shift from rules to outcomes may be undone by excessive guidance. However, it did recognise that guidance for certain sectors of a regulated community may well be of benefit to those practitioners. The CLC, as noted above, reiterated its point that education and training standards could form a separate constituent part of the regulatory standards

## *LSB response*

99. Our response to question two (see pages 12 – 15) addressed many of the issues raised by the BSB. It remains our view that the approved regulators must prioritise the protection of consumers from unacceptable risks by setting out clear outcomes that consumers can expect from legal services providers. We do accept that on some occasions the regulatory objectives may be in tension. However, consider that such tension is more easily resolved through a focus on the outcomes expected of legal services providers rather than rules which can never cover every conceivable eventuality.
100. We agree with the Legal Services Consumer Panel's view that guidance for certain types of entity, such as small firms, can be helpful. We also agree that a move to outcomes focused regulation should not be supplanted by a proliferation of guidance that forms a prescriptive rule based regime.
101. We do not agree with the CLC's view that education and authorisation form a separate constituent aspect of regulation. We recognise that these aspects form a crucial part of regulation. However, we believe authorisation sits alongside regulation of conduct and provides consumers with services from practitioners who have appropriate levels of skills and training.

## Risk Assessment

102. The BSB noted that collection of data can be burdensome and felt that a balanced approach should be taken, pointing out that a requirement to obtain large quantities of information without a clear purpose would be disproportionate and burdensome. The CLC suggested that the outputs of risk identification should also determine consumer engagement activity.
103. The Legal Services Consumer Panel is supportive of risk assessment. However, it noted that there are issues around the quality of information used in making assessments, the transparency of regulators' risk assessment policies and the transparency of firm specific risk ratings. It also felt that consumer detriment must be one of the key drivers of assessments and policies must recognise that consumers are not homogenous and therefore there is a need to cater for consumers at a risk of disadvantage. It noted that the BSI standard on consumer vulnerability together with the LSB's consumer toolkit<sup>14</sup> would represent useful thinking on consumer detriment.
104. The Legal Ombudsman was interested in understanding the role that it can play in the sharing of learning and feedback to the profession and the regulators.

## LSB response

105. The Hampton principles, which form an integral part of the better regulation principles within the Act and the Regulators' Compliance Code, make it clear that regulators are expected to use comprehensive risk assessment to concentrate resources in the areas that need them most. However this does not necessarily require the collection of vast amounts of data. Indeed the code makes it clear that this does not mean that practitioners must provide unnecessary information or duplicate information. Nevertheless, regulators must gather sufficient data on which to base their regulation.
106. We agree with the Legal Services Consumer Panel's view that regulators should be encouraged to be transparent in their risk assessment policies. However we do not expect approved regulators to publish information about a specific firm's risk profile since this may be damaging commercially even though the risks are being managed by the approved regulator.
107. Data is already shared between the Ombudsman and the approved regulators. We encourage further development of this. The Ombudsman may be able to provide useful data on trends and themes to supplement approved regulators existing data and risk assessment information.

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<sup>14</sup> Opinion Leader (2011), *Legal Services Board: Developing measures of consumer outcomes for legal services*, LSB London, <[http://www.legalservicesboard.org.uk/news\\_publications/latest\\_news/pdf/consumer\\_outcomes\\_final\\_research\\_report.pdf](http://www.legalservicesboard.org.uk/news_publications/latest_news/pdf/consumer_outcomes_final_research_report.pdf)> Accessed December 2011.

## Supervision

108. The BSB argued strongly that *“regulators should not be compelled to be pro-active for pro-activity’s sake. Simply undertaking activity reactively is not going to be sufficient but proactive action must be judiciously and sensibly approached”*. The CLC noted that good supervision needs to be fast and fair in the same way that enforcement does and that the proportionality of the approach adopted should be based upon regular feedback from the relevant regulated community.

## LSB response

109. Supervision should always be a balance between pro-activity and reactivity. However we would not accept an approach which did not utilise risk information to undertake proactive supervision. We also support the CLC’s view that supervision should be fast and fair. As the Hampton principles makes clear; inspections are likely to be most effective when they are justified and targeted on the basis of an assessment of risk.

## Enforcement

110. The CLC suggested that *“this element may also benefit from an ‘effectiveness’ indicator i.e. the enforcement action taken does not have to be repeated and delivers the outcomes sought, as well as the factor of ‘timeliness/speed’”*. Other respondents discussed the issue of publicity, with the BSB cautioning against *“publicity at all costs”* and the Legal Services Consumer Panel advocating harnessing consumer buying power to promote compliance. It argued that the publication of disciplinary action at firm level provides reputational incentive to maintain good service standards. It also noted that such an approach is in line with the recently published BIS consumer empowerment strategy. The Legal Ombudsman was also very interested to hear the LSB’s thoughts on transparency and data publication.

## LSB response

111. The LSB agrees that an important element of enforcement action is the deterrence that the threat of publicity brings. It is common in other regulatory regimes for regulatory action to be made public and we can see no reason why this should not be the approach in legal services. We also support the CLC’s views that the effectiveness of a regulator’s enforcement process – including



timeliness and deterrence – is an important aspect of this constituent part of regulation and the self-assessment template has been amended to reflect the importance of it and the role of feedback in the process.

### **Capability and capacity**

112. Only a small number of comments were received on this constituent part. The CLC felt that it could be usefully separated out from the other four constituent parts of regulation. This is because it is more clearly a performance assessment standard rather than assessment of an aspect of regulation. The Legal Services Consumer Panel suggested including an additional indicator in this section related to regulatory transparency in both regulators' decision making and their interventions.

### ***LSB response***

113. The LSB agrees with the CLC that this aspect is a separate style of assessment from the assessment of the four constituent parts of regulation. This is more clearly a performance assessment. However without the appropriate level of capacity and capability the regulator will struggle to deliver the four constituent parts of regulation and so the requirements of the Act. This is why it will form an important part of the assessment.
114. In response to the Legal Services Consumer Panel comment on regulatory transparency we have amended the assessment to include a requirement that consumers are confident that the regulation is transparent as well as independent.

## Annex A: Self-assessment template

### Regulatory standards

The overall approach is for Approved Regulators and Licensing Authorities (AR/LAs) to self-assess their own level for each constituent part of regulation as well as their own capacity and capability.

The self-assessment is on the following scale:

- Good- all indicators embedded appropriately in the organisation and inform day to day working practices
- Satisfactory – significant progress is being made to embed indicators and use them in day to day working practices
- Undertaking improvement and work is well underway– indicators have been introduced but are not yet embedded appropriately in the organisation and do not yet inform day to day working practices
- Needs improvement and work has started recently

Alternatively, the AR/LA has the option to state: recognise this needs to be done but work has not yet started

We consider that all of the constituent parts apply to all ARs and so “not applicable” is not an acceptable response. Below each of the constituent parts are factors that indicate where an organisation might be on the scale. AR/LAs must use these factors to assess initially whether they are towards the top or bottom of the scale and provide that information in the self-assessment. However, AR/LAs are free to add sector-specific factors as well. All additional sector specific factors must be justified with reference to evidence. AR/LAs may also wish to use the indicators in box 3 on page 28 of the regulatory standards decision document as a guide.

In order to provide a consistent framework for understanding the legal services market, AR/LAs must use the Oxera report “A framework to monitor the legal services sector” published by the LSB on 28 September 2011 when considering the extent of their knowledge about consumers, the supply of legal services and the market(s) they regulate. For example, paragraph 2.1.3 of that report explains why there may be limited demand-side substitution because consumers need a specific type of legal advice for their problem; there may also be limited supply side-substitution if it is not possible for lawyers to switch to providing a different type of advice within a reasonable timescale. We would expect an AR/LA with a good understanding of the market(s) it regulates to be able to provide evidence about the types of consumer problems that occur, the extent to which supply-side substitution is possible, the barriers to supply-side substitution, the risk of consumer detriment that arises and an assessment of whether any regulatory action is required to mitigate that risk.

AR/LAs must provide clear analysis and evidence of how it arrived at the rating together with an Action Plan for development going forward with challenging but realistic targets/timescales.

Lay Board involvement is preferable in completing the self-assessment; additional independent scrutiny may also be appropriate. Board sign off on the final submission is required.

LSB will publish a high level summary of the AR/LA's assessment and Action Plan.

For AR/LAs completing the self-assessment with any questions on the process or would like further details on what is expected please contact Fran Gillon ([fran.gillon@legalservicesboard.org.uk](mailto:fran.gillon@legalservicesboard.org.uk)) or James Meyrick ([james.meyrick@legalservicesboard.org.uk](mailto:james.meyrick@legalservicesboard.org.uk))

**Please provide details of a senior contact at the AR/LA who will be responsible for responding to LSB queries on the self-assessment:**

Full name:

Job Title:

Contact details (including telephone and email address):

### *Outcomes focused regulation*

To what extent does the AR/LA have regulatory arrangements based on the outcomes that consumers need?

Factors that indicate that the AR/LA is towards top of the scale:

- Regulatory arrangements deliver the outcomes that consumers need; there is clear evidence and analysis to justify any detailed rules; those regulated understand and accept approach to regulation;
- All members of staff and Board understand the organisation's approach to focusing regulation on the consumer and public interest;
- High quality, up to date, reliable evidence from a range of sources about how all groups of consumers need and use the legal services the AR/LA regulates; evidence about whether outcomes are being achieved; consumers have confidence in regulation. Regularly reviews and updates its regulatory arrangements based on that evidence.

Factors that indicate that the AR/LA is towards bottom of the scale:

- Predominately rule based regulation; high levels of prescription with no clear evidence base;
- Some resistance to moving to consumer-based outcomes by Board and/or those regulated;
- Little or no up to date evidence about consumers; decisions often based on lawyers' needs/views.

<b><i>Outcomes focused regulation</i></b>	To what extent does the AR/LA have regulatory arrangements based on the outcomes that consumers need?	
<b>Scale</b>	<b>Please mark your overall assessment against the scale for this standard</b>	
Good		
Satisfactory		
Undertaking improvement and work is well underway		
Needs improvement and work has started recently		
Recognise this needs to be done but work has not yet started		
<b>Questions for response</b>	<b>Text</b>	
Rationale for assessment:		
Evidence to support assessment:		
References to relevant supporting documentation:		
Details of action plan with timescales and milestones (including work identified but not begun, work recently started and work already underway):		
References to relevant action plan documentation:		

### ***Risk assessment***

To what extent does the AR/LA have a formal risk assessment processes at key stages of its regulatory decision making processes?

Factors that indicate that the AR/LA is towards top of the scale:

- Formal, structured, transparent and evidence-based approach to identification and mitigation of risks across the whole range of entities and individuals that the AR/LA regulates. Risk analysis focuses predominantly on consumer detriment, including those in vulnerable circumstances. Evidence that approach to risk works in practice;
- Approach to evidence gathering for risk assessment enables the identification of future trends as well as current issues;
- Relevant staff and Board understand the reasons for risk assessment, how it informs other aspects of the AR/LA's activities. Staff share best practice and lessons learned in a structured and effective way.

Factors that indicate that the AR/LA is towards bottom of the scale:

- Some understanding of the main areas of risk but little evidence on which to base its approach;
- Relatively static approach, often or predominantly retrospective;
- No clear link between view of risk and other activities.

<b><i>Risk assessment</i></b>	To what extent does the AR/LA have formal risk assessment processes at key stages of its regulatory decision making processes?	
<b>Scale</b>	<b>Please mark your overall assessment against the scale for this standard</b>	
Good		
Satisfactory		
Undertaking improvement and work is well underway		
Needs improvement and work has started recently		
Recognise this needs to be done but work has not yet started		
<b>Questions for response</b>	<b>Text</b>	
Rationale for assessment:		
Evidence to support assessment:		
References to relevant supporting documentation:		
Details of action plan with timescales and milestones (including work identified but not begun, work recently started and work already underway):		
References to relevant action plan documentation:		

## *Supervision*

To what extent does the AR/LA have supervisory processes that are consistent with the principles of better regulation?

Factors that indicate that the AR/LA is towards top of the scale:

- Supervisory activity:
  - is underpinned by an evidence-based understanding of different market segments and providers that the AR/LA regulates;
  - is determined by reference to identified risks;
  - is informed by data from the Legal Ombudsman;
  - facilitates innovation, change and commercial freedom; and
  - is adequately resourced (including the use of fit for purpose technology) to provide good quality, consistent decisions without backlogs.
- Clear and structured feedback loops between supervisory activity, risk assessment, staff learning and best practice;
- Regular senior management and Board monitoring of effectiveness and value for money of supervisory activity leads to improved processes.

Factors that indicate that the AR/LA is towards bottom of the scale:

- Supervisory activity is predominately reactive;
- Little co-ordination of experience and best practice development;
- Few incentives to improve effectiveness or value for money.



<b>Supervision</b>	To what extent does the AR/LA have supervisory processes that are consistent with the principles of better regulation?	
<b>Scale</b>	<b>Please mark your overall assessment against the scale for this standard</b>	
Good		
Satisfactory		
Undertaking improvement and work is well underway		
Needs improvement and work has started recently		
Recognise this needs to be done but work has not yet started		
<b>Questions for response</b>	<b>Text</b>	
Rationale for assessment:		
Evidence to support assessment:		
References to relevant supporting documentation:		
Details of action plan with timescales and milestones (including work identified but not begun, work recently started and work already underway):		
References to relevant action plan documentation:		

## ***Enforcement***

To what extent does the AR/LA have enforcement processes that are consistent with the principles of better regulation?

Factors that indicate that the AR/LA is towards top of the scale:

- Published policies and guidelines are written in plain language that enables others to understand the criteria for deciding to take action; appeal processes follow best practice;
- A wide range of effective, proportionate enforcement tools that can be deployed quickly by staff who have appropriate levels of experience and are well trained; enforcement powers provide appropriate incentives for compliance; enforcement penalties punish as well as deter; regular senior management and Board monitoring of effectiveness and value for money of enforcement activity feeds back to improved processes and reduced costs;
- Decisions to take (and not to take) enforcement action are evidence based and use reliable sources.

Factors that indicate that the AR/LA is towards bottom of the scale:

- Little or no evidence of structured approach to enforcement activity. Lack of appropriate levels of expertise amongst staff;
- Narrow range of enforcement powers; powers tend to be inflexible;
- Appeal processes that are time consuming and expensive with little control over costs.

<b>Enforcement</b>	To what extent does the AR/LA have enforcement processes that are consistent with the principles of better regulation?	
<b>Scale</b>	<b>Please mark your overall assessment against the scale for this standard</b>	
Good		
Satisfactory		
Undertaking improvement and work is well underway		
Needs improvement and work has started recently		
Recognise this needs to be done but work has not yet started		
<b>Questions for response</b>	<b>Text</b>	
Rationale for assessment:		
Evidence to support assessment:		
References to relevant supporting documentation:		
Details of action plan with timescales and milestones (including work identified but not begun, work recently started and work already underway):		
References to relevant action plan documentation:		

### *Capacity and capability*

To what extent does the AR/LA have the necessary Board and staff capacity and capability to deliver the regulatory objectives?

Factors that indicate that the AR/LA is towards top of the scale:

- Clear and consistent leadership at Board and senior management level that ensures that the whole organisation has strong consumer engagement and consumer focus. Consumers are confident that regulation is independent;
- Appropriate levels of budget and staffing linked to the nature of the market(s), entities and individuals regulated; required skill sets are defined and linked to the key challenges facing the organisation, to the regulatory objectives and to the AR/LA's regulatory outcomes – which are achieved in practice. Organisation's structure enables effective decision making by appropriate delegation of powers to staff;
- Evidence-based understanding of the market(s) it regulates and the commercial realities of operating in it. High levels of knowledge management and analytical skill at all levels in the organisation drives culture of transparency, continuous improvement and embeds best regulatory practice from legal regulation and other industries.

Factors that indicate that the AR/LA is towards bottom of the scale:

- Consumer interest not yet embedded at all levels across Board or staff, or in regulatory arrangements;
- Budget/staffing levels/structure that inhibit regulatory capacity; Board members heavily involved in many aspects of day to day work; little focus on LSA requirements;
- Little management information about those regulated; little or no analysis or understanding of the market(s) they operate in.

<b><i>Capacity and capability</i></b>	To what extent does the AR/LA have the necessary Board and staff capacity and capability to deliver the regulatory objectives?	
<b>Scale</b>	<b>Please mark your overall assessment against the scale for this standard</b>	
Good		
Satisfactory		
Undertaking improvement and work is well underway		
Needs improvement and work has started recently		
Recognise this needs to be done but work has not yet started		
<b>Questions for response</b>	<b>Text</b>	
Rationale for assessment:		
Evidence to support assessment:		
References to relevant supporting documentation:		
Details of action plan with timescales and milestones (including work identified but not begun, work recently started and work already underway):		
References to relevant action plan documentation:		

## Self-assessment certification

In order to assure the LSB of the accuracy of the self-assessment we require the following to certify the contents of the self-assessment and any accompanying documents:

- A member of the regulatory board, preferably lay, who has been involved in the completion of the assessment;
- The Chair or equivalent of the regulatory board on behalf of the entire regulatory board;
- The independent scrutiniser (where used) or alternatively the member of the regulatory board, preferably lay, who has been involved in the completion of the assessment must confirm the reasons for not seeking independent scrutiny.

**Regulatory Board Member:** On behalf of [the AR/LA's] regulatory board, I, member of said regulatory board, certify that I have taken reasonable steps to satisfy myself that the information contained within this self-assessment and accompanying documents are accurate, that the procedures followed to make the assessment provided a reasonable basis to reach a judgement and each ranking represent a fair and reasonable assessment:

<p style="text-align: center;">X _____</p> <p style="text-align: center;">Member of regulatory board</p>	<p>Full name and date:</p>
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**Regulatory board:** On behalf of the [the AR's] regulatory board, I certify that the regulatory board has reviewed this completed self-assessment and has come to a reasonable opinion, after having made due and careful enquiry, that the information and judgements contained within this assessment are made on a reasonable basis:

<p style="text-align: center;">X _____</p> <p style="text-align: center;">Chairman/equivalent of regulatory board</p>	<p>Full name and date:</p>
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**Independent scrutiny**

The LSB requires that each regulator either subjects their completed self-assessment to independent scrutiny or explains why they chose not to do so. The independent scrutiny can be completed by an appropriate professional, expert or consultant. This can include individuals sitting on other legal services regulatory boards. They should not be current or previous members of the regulatory board under consideration. This individual must provide their contact details, any professional accreditation and signature on the submitted self-assessment.

**If the self-assessment was independently reviewed:** I confirm that I, as an independent scrutiniser of this self-assessment, have taken reasonable steps to satisfy myself that the regulatory board and its executive have followed appropriate procedures which provide a reasonable basis for them to make the judgements contained within this self-assessment and in any other documents submitted alongside this self-assessment:

X \_\_\_\_\_  
Independent scrutiniser

Full name: \_\_\_\_\_

Date: \_\_\_\_\_

Job title and / or profession:  
\_\_\_\_\_  
\_\_\_\_\_

Business name and address:  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_



**If the self-assessment was not independently reviewed:**

On behalf of the AR/LA's regulatory board, I, member of said regulatory board declare that the regulatory board decided against seeking independent scrutiny of the completed self-assessment for the following reasons:

This self assessment was not independently reviewed for the following reasons:	
<p>X</p> <hr/> <p>Member of regulatory board</p>	Full name and date:

## Annex B: Glossary of terms

<b>ABS</b>	Alternative Business Structures. From October 2011 non-legal firms have been able to offer legal services to their customers in a way that is integrated with their existing services. Or law firms will be able to develop their portfolios to compete across wider areas compared with their existing experience.
<b>AR or approved regulator</b>	A body which is designated as an approved regulator by Parts 1 or 2 of schedule 4 to the Legal Services Act 2007, and whose regulatory arrangements are approved for the purposes of the LSA and which may authorise persons to carry on any activity which is a reserved legal activity in respect of which it is a relevant AR
<b>BSB</b>	Bar Standards Board – the independent regulatory arm of the Bar Council
<b>CLC</b>	Council for Licensed Conveyancers – the regulator of Licensed Conveyancers
<b>Consultation</b>	The process of collecting feedback and opinion on a policy proposal
<b>ILEX Professional Standards Board</b>	Institute of Legal Executives – the independent regulatory arm of the Institute of Legal Executives
<b>LA or Licensing Authority</b>	An AR which is designated as a licensing authority to license firms as ABS
<b>LSB or the Board</b>	Legal Services Board – the independent body responsible for overseeing the regulation of lawyers in England and Wales
<b>LSA or the Act</b>	Legal Services Act 2007
<b>Principles of Better Regulation</b>	The five principles of better regulation: proportional, accountable, consistent, transparent and targeted

<b>Regulatory Objectives</b>	<p>There are eight regulatory objectives for the LSB that are set out in the Legal Services Act (2007):</p> <ul style="list-style-type: none"> <li>• protecting and promoting the public interest</li> <li>• supporting the constitutional principle of the rule of law</li> <li>• improving access to justice</li> <li>• protecting and promoting the interests of consumers</li> <li>• promoting competition in the provision of services in the legal sector</li> <li>• encouraging an independent, strong, diverse and effective legal profession</li> <li>• increasing public understanding of citizens legal rights and duties</li> <li>• promoting and maintaining adherence to the professional principles of independence and integrity; proper standards of work; observing the best interests of the client and the duty to the court; and maintaining client confidentiality.</li> </ul>
<b>Reserved Legal Activity</b>	Legal services within the scope of regulation by the Approved Regulators
<b>SRA</b>	Solicitors Regulation Authority – independent regulatory Arm of the Law Society

## **List of consultation respondents**

Bar Standards Board (BSB)

Costs Lawyer Standards Board (CLSB)

Council for Licensed Conveyancers (CLC)

Emmersons Solicitors

ILEX & ILEX Professional Standards (joint response)

Institute of Chartered Accountants in England and Wales (ICAEW)

The Law Society

Legal Ombudsman (LeO)

Manchester Law Society

Solicitors Regulation Authority (SRA)