



## CLC response to LSB Consultation on Developing Regulatory Standards

1. *Do you agree with our analysis of the changing legal services market? Are there other factors that should be taken into consideration?*
  - 1.1 We agree with the factors identified by the LSB and would also add:
    - i) the authorisation of more than one Licensing Authority;
    - ii) the broadening of Approved Regulators' (ARs) regulatory scope; and
    - iii) the pressure to improve regulatory effectiveness in other sectors such as financial services, which invariably impact on the legal services market.
  - 1.2 These factors will improve the range of regulatory choice available to legal services providers (and their clients) and set new benchmarks for regulatory performance.
  - 1.3 In the last 2 decades, as a result of a number of factors – such as changing business models, increasing competition, a fragile economic climate (alongside reductions in bank finance and capital in the insurance sector), and increasing provisions of online services widening of access routes (as well as speed of transactions) - the legal services market has become increasingly plural. The advent of both Alternative Business Structures and regulation which is explicitly Outcomes-focused is likely to further quicken and broaden the scope of such change.
2. *Do you agree with our focus on outcomes-focused regulation; risk identification framework; proportionate supervision; and, appropriate enforcement strategy?*
  - 2.1 We agree that outcomes-focused regulation; risk identification; proportionate supervision; and an appropriate enforcement strategy are key elements of an effective regulatory regime. However, we are of the view that outcomes focused regulation is pervasive across the regulatory value chain and therefore has a different relationship to the proposed three key elements. In terms of hierarchy we see the other three proposed elements flowing from and directly impacted by the outcomes focused regulatory approach.
  - 2.2 Furthermore, we suggest that another key element of effective regulation which has not been appropriately recognised is robust - i.e. proportionate and

risk-based - licensing/authorisation. We consider that robust licensing is of equal importance to proportionate supervision (and not just a subset of proportionate supervision) and from our experience, in many ways proportionate supervision is made possible and underpinned by appropriate management of the licensing 'gateway'.

2.3 We therefore suggest that the LSB considers a focus on five elements which include robust licensing and which recognise outcomes-focused regulation as the umbrella or overarching element.

2.4 Within the changing market we recognise that prescriptive rules are less appropriate because of the increasing range of business models and risk variation. ARs will need to ensure risks to the Outcomes – and by that, the regulatory objectives set out in the Legal Services Act (LSA) - are identified and managed. Outcomes-Focused and Risk-Based Regulation (OFR) is central to this agenda (and to the CLC's approach) as it affords the regulated community flexibility in delivery of the specified Outcomes - whilst holding them responsible for how they do so – and allows us the opportunity to focus upon those firms, individuals and activities which put the Outcomes at risk. Our recently approved Licensing Authority application sets out our commitment to OFR.

2.5 Whilst enabling flexibility and promoting responsibility we must in turn ensure that where this is abused, or there is a potential risk of this, that the relevant individual, firm, activity, or area of the sector, is held accountable. This is achievable only through proportionate supervision and an appropriate enforcement strategy.

3. *How do you think a more flexible and responsive regulatory regime should be developed?*

3.1 We consider the development of a more flexible and responsive regulatory regime is very dependent on effective implementation of outcomes-focused regulation. The CLC is already moving steadily towards a regulatory regime which is both more flexible (e.g. principles-based, rather than rules-based) and responsive (i.e. risk-based; rewarding those who have earned it, with increased autonomy and focusing our activities on those firms, persons and activities which put the Outcomes at risk). Our outcomes-focused regulatory arrangements – the new CLC Handbook and Frameworks and other new elements of its regulatory arrangements - will come into force in October 2011.

3.2 Developing a better understanding of emerging strategic markets risks in legal services and the correlation with other risk categories - such as entity and individuals - should facilitate the development of a more flexible and responsive regulatory regime.

3.3 The development of such a regime should be supported by a shared understanding of the acceptable risk tolerance level for ARs. A regulatory culture where ARs are enabled and not dis-incentivised from adopting new ways of regulation, underpinned by an effective feedback loop (lessons learned), should stimulate a more flexible and responsible regulatory regime.

4. *We would welcome views on whether self-assessment is an appropriate approach or whether the LSB should deliver its oversight by conducting its own reviews.*
- 4.1 We consider self-assessment to be an appropriate approach affording ARs the same ownership and accountability which OFR will offer their regulated communities. Furthermore, we consider self-assessment to be consistent with the proposed principle of proportionate oversight supervision by the LSB. However, we consider the December 2011 submission timescale would be challenging taking into account that ARs would have only three months in which to complete the exercise alongside all their other commitments (a period in which the CLC will launch Outcomes-Focused Regulation and assume Licensing Authority status).
5. *What are your views on the benefits, costs and risks to ARs and their regulated communities of our proposals?*
- 5.1 We are confident that in time the benefits of the self-assessment - to both the ARs and their regulated communities - should outweigh its costs. However, the realisation of such benefits is heavily dependent on the implementation approach adopted for the modernisation of regulation.
- 5.2 We consider that should a rapid pace of implementation be imposed it would present risks to ARs, in terms of acquisition and retention of specialist staff; as well as the burden of additional costs to the regulatory community (the development costs may be shared by relatively smaller regulatory communities over a less than desirable short investment period).
- 5.3 Furthermore, rapid implementation of new regulatory arrangements would present risks for ARs as there may not be adequate time to work with their respective regulatory communities to address any resistance to change. It would also limit the support provision afforded the regulated community, usually necessary in any significant change management endeavour as is potentially envisaged by this modernisation agenda.
- 5.4 We are also concerned that a rapid pace of change presents risks that ARs may not be able to focus on the learning aspects of implementing new process as recommended by best practice.
- 5.5 The impact of the proposed changes is two-fold. Firstly, as highlighted above, the timescale for completing the proposed self assessment exercise is very challenging considering the other LSB-inspired priorities - as well as our launch of Outcomes-Focused Regulation and assumption of Licensing Authority status - which overlap during the same period. Secondly, and perhaps of greater impact, is the approach adopted by the LSB to the required corrective action plan following the self assessment process. If an ambitious timescale for addressing identified issues is expected, then this may have a major adverse impact on other priorities.
- 5.6 Overall we are hopeful that if a pragmatic approach is adopted to the modernisation agenda, that both the benefits to both ARs and their regulatory communities would outweigh the risks.
- 5.7 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. Both the extent of the resultant commitment and its cost is likely to vary according to the AR and the extent to which it will need to change in order to deliver the relevant key indicator(s).

- 5.8 The risks for the CLC are that the self-assessment will be carried out too soon after the introduction of our OFR approach. If the self-assessment is completed after six months of OFR – say in May or June 2012 – rather than in December 2011 (when the OFR regime will have been launched only two months previously), the CLC will be informed by its experience in applying the OFR approach, whilst it will still be early enough to enable improvements to be made within a year of its implementation.
6. *We would particularly welcome feedback on the criteria at Annex A, including suggestions on others that might be appropriate.*

We comment as follows on the key indicators/criteria:

#### 6.1 Outcomes-focused regulation

- a) It should be made explicit that the Outcomes sought need to be compatible with the LSA's regulatory objectives.
- b) Education and Training Standards seem out of place in this section, reinforcing our suggestion under question 2 that a new element is required.
- c) The 'effective' advisory services for regulated entities and individuals indicator may benefit from a 'proportionate' reference; as any assessment of effectiveness should consider item 5.7 of the Regulators Compliance Code which requires regulators to take account of needs and circumstances of the particular entity and the possibility of charging (a reasonable fee) for services which go beyond 'basic advice and guidance necessary to help ensure compliance'.

#### 6.2 Risk Assessment

- a) The key indicators should make explicit reference to the risks being those which threaten the specified Outcomes in order that what is defined as risk is not open to interpretation.
- b) We suggest there should be a focus on market risks that impact upon both entity and individual i.e. 'thematic as well as firm-specific' criteria (as found under 'Supervision'), and that outputs of risk identification should also determine consumer engagement activity.

#### 6.3 Supervision

- a) Bullet points 2 and 3 are very similar in scope – i.e. proactivity/ forward-looking – and may need further clarification or definition.
- b) We suggest that the proportionality of the approach is based upon regular feedback from the AR's regulated community.

- c) This element may benefit from a 'fast and far' indicator, as is provided under 'Enforcement'.

#### 6.4 Enforcement

- a) Bullet points 5 and 7 are very similar in scope – i.e. deterrence/ publicity – and may benefit by being amalgamated or streamlined.
- b) 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'.

#### 6.5 Capability and capacity

- a) We are of the view this is not criteria for regulatory standards but for performance assessment. This muddies the waters and we suggest that this element is placed in a new section called performance assessment.
- b) Bullet point 3 (i.e. the right capability and capacity across the regulator), appears to be unnecessary as bullet point 2 (i.e. proper level of resource and people already covers this area).

#### 6.6 Other

Partnership working – including, but not limited to information-sharing - is an essential element of effective cross-sector regulation. It would be beneficial if an indicator could include this consideration.

