

Setting the maximum financial penalty for ABS licensing

A consultation paper setting out proposals under section 95 of the Legal Services Act.

This consultation will close on **24 January 2011**

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Introduction

- 1 The Legal Services Board (the “**LSB**”) is one of the organisations created by the Legal Services Act 2007 (the “**LSA**”) and is responsible for overseeing legal regulators, (referred to as the approved regulators (“**ARs**”) in the LSA) in England and Wales. The LSB’s mandate is to ensure that regulation in the legal services sector is carried out in the public interest and that the interests of consumers are placed at the heart of the system. The LSA gives the LSB and the ARs the same regulatory objectives – including an objective to promote competition within the provision of legal services – and a requirement to have regard to the better regulation principles.
- 2 The LSA also makes provision for approved regulators to apply to the LSB to become designated as licensing authorities (“**LAs**”). As a LA they may issue licences to legal services businesses that have some element of non-lawyer ownership commonly referred to as alternative business structures (“**ABS**”) but known in the LSA as licensed bodies.
- 3 The Act requires the LSB¹ to make rules by statutory instrument² that prescribe the maximum penalty that may be imposed by a LA on an ABS. The Lord Chancellor must give his consent to these rules before they can be made³. Each LA will have their own licensing rules that will set out their approach to financial penalties. These form part of the LA’s regulatory arrangements and have to be approved by the LSB. Each particular penalty has to be of an amount that the LA considers appropriate.
- 4 In November 2009 we consulted on this issue as part of our wider consultation on the rules relating to the regulation of ABS⁴. We proposed at that time that there should be no limit on the penalty that a LA could impose. In March 2010 we confirmed this as our position in our guidance to LAs⁵ having received a large number of consultation responses in support.
- 5 However, in October we were told by the Ministry of Justice that they do not consider that the wording of the LSA permits an unlimited penalty and they are therefore unable to recommend to the Lord Chancellor that he consents to the rules. This paper sets out the LSB’s alternative approaches to setting a maximum amount. It proposes that the maximum financial penalty that can be imposed should be set at £150,000,000 for entities and £50,000,000 for individuals. A draft statutory instrument (SI) is at Annex B. Please note that

¹ LSA s95(3)

² LSA s206(6)

³ LSA s95(4)

⁴ http://www.legalservicesboard.org.uk/what_we_do/consultations/2009/pdf/consultation_181009.pdf

⁵ http://www.legalservicesboard.org.uk/what_we_do/consultations/closed/pdf/abs_guidance_on_licensing_rules_guidance.pdf

this is a short consultation period as we have already consulted on the substantive issues around enforcement against ABS and previously consulted on a maximum for penalties that was higher (unlimited) the one proposed.

Considerations for setting the maximum for any penalty

6 In general, when enforcing against an ABS, a LA must take into account the Better Regulation principles. We consider that it is appropriate for LAs to also have regard to the Regulators' Compliance Code⁶ which aims to embed in regulators a risk-based, proportionate and targeted approach to enforcement. This is in addition to the statutory duty in the LSA to have regard to the better regulation principles.

7 As we state in paragraph 97 of our guidance to licensing authorities⁷:

Financial penalties are likely to be used when, in the LA's judgement, it is appropriate to attempt to change the behaviour of the licensed body or an employee or manager, and to deter future non-compliance. We expect LAs' licensing rules to set out the criteria it will apply in deciding whether to impose a penalty and the factors it is likely to take into consideration when deciding the appropriate level of any penalty (up to the maximum level in the LSB's rules as consented to by the Lord Chancellor). There is a requirement for the LA to act proportionately to the circumstances of the particular case. It is important that LAs retain maximum flexibility to decide whether to impose a penalty on an individual or an entity or both, and the amount of the penalty. We do not consider it reasonable for a LA to set out indicative penalties in its licensing rules since this can distort behaviours and provide an incentive to "game" the compliance regime.

8 LAs' licensing rules (including their approach to financial penalties) are subject to the LSB's rule approval process including:

- a. the acts and omissions in respect of which the licensing authority may impose a penalty under section 95, and
- b. the criteria and procedure to be applied by the licensing authority in determining whether to impose a penalty under that section, and the amount of any penalty.

9 In addition paragraph 98 of our guidance to licensing authorities⁸ provides further detail:

We expect the LAs to take into account the LSB's own enforcement process and best practice by regulators generally, including the Code of

⁶ <http://www.berr.gov.uk/files/file53268.pdf>

⁷ http://www.legalservicesboard.org.uk/what_we_do/consultations/closed/pdf/abs_guidance_on_licensing_rules_guidance.pdf

⁸ *ibid*

Practice for Regulators. If the LA is investigating a number of breaches as separate investigations, it may be appropriate for each investigation to impose a separate penalty, in each case.

- 10 The LSA also makes provision for appeals against the financial penalties imposed by a LA⁹. The grounds for appeal include that the amount of the penalty is unreasonable. The appellate body has the power to quash the penalty or substitute a lesser amount. This acts as a further safeguard against LAs applying disproportionately high penalties. Any maximum must also be able to provide a credible deterrent effect¹⁰.
- 11 Furthermore, during the passage of the LSA, the Solicitors Disciplinary Tribunal's ("SDT") previous maximum fine was amended by the Act¹¹ to remove the then maximum of £5,000. The effect of this was that the SDT can now impose an unlimited penalty. Given the scale of abuse that is possible in extreme cases, the LSB believes that the decision to remove the very low cap was strongly justified in policy terms.
- 12 In general, we want to see a level playing field with similar means of consumer protection, regulatory supervision and incentives to prevent poor behaviour wherever possible for ABS and non-ABS firms. In practice this means seeking similar outcomes for both types of firm (and for consumers). The challenge is to find the most effective way of achieving this outcome, given the current differences in regulatory design.
- 13 One key question is whether the right comparator is with the current constrained ability to fine of the front line regulators or with the SDT's unlimited power. We believe that the latter is the correct comparator. At present, the SRA prosecutes in front of the SDT who can impose any financial penalty (with appeal to the High Court). On the other hand, a LA will be imposing a penalty directly on an ABS, but the ABS appellate body can only reduce or quash the penalty¹²). Rules about the level of fine necessary to achieve the right deterrent effect therefore need to be made by LAs, within the framework set by the LSB, rather than at appellate body level. The LSB therefore considers it appropriate to use our rule making powers to seek to achieve the same deterrent outcome.
- 14 LAs can impose financial penalties on entities and individuals therefore the methodology for setting any maximum amount will need to take this into account. Given the safeguards in place to ensure that LAs act proportionately,

⁹ LSA s96

¹⁰ For discussion on the effectiveness of deterrence in fining from the OFT see: http://www.of.gov.uk/shared_of/reports/Evaluating-OFTs-work/oft962.pdf and http://www.of.gov.uk/shared_of/economic_research/oft1132.pdf

¹¹ Schedule 16 paragraph 49(d)

¹² LSA s96(3)

the support we had for our previous position and trying to achieve practical (if not actual) equivalence with the unlimited penalty that the SDT can impose, our aim is to set a maximum that provides sufficient “headroom” for LAs to be able to set proportionate penalties in *all* situations. We accept that this may mean a maximum limit that is hardly ever approached in practical decision-making, but we believe that giving LAs the power, subject to robust appeal arrangements, to react appropriately in all circumstances will build public and industry confidence more effectively than hasty revision of the scheme to react to any particularly egregious case.

- 15 Broadly speaking therefore we want to set a maximum penalty that sufficiently high not to constrain the decisions of the LA. The maximum penalty should also be high enough to ensure that a person or entity that is subject to a penalty will not have benefited from their wrongdoing¹³. The next section sets out two approaches for setting such a maximum and discusses what the maximum should be.

Options for setting the maximum for any penalty

Calculating an amount

- 16 Calculation of penalties in regulation is often done in terms of the turnover of the firm to which the penalty is being applied¹⁴. Often for economic regulators and competition authorities, this is set at 10% of the relevant turnover. Indeed, the LSB’s own powers to set a penalty are set as a percentage (5%) of the approved regulator’s turnover.
- 17 The advantage of an approach like this is that it sets in relative terms the maximum amount that would be proportionate given a particular firm’s size. One of the disadvantages of moving to a penalty based on turnover is defining what the appropriate turnover should be. If, say, it was set at 10% (itself an arbitrary level) and the LA wished to set a penalty at the top of the range there would be strong incentives for the ABS to argue that the calculation of turnover was incorrect and the penalty was unlawful (rather than arguing that the amount was unreasonable).
- 18 If the maximum amount were set as a proportion of total turnover of the entity then this may need to include information on global turnover (for example if part of the business is run offshore) which may be difficult to obtain. UK based turnover may be easier to assess but it may be argued that it should only relate to the regulated part of the business – to ensure equivalence for competitors in the market. However, this may create perverse incentives in

¹³ For a discussion of these issues see:

Hampton report (esp. paras 2.80 and 2.86) (<http://www.berr.gov.uk/files/file22988.pdf>)
Julia Black 'A Review of Enforcement Techniques', Appendix A, Law Commission, Criminal Liability in
Regulatory Contexts: A Consultation Paper: http://www.lawcom.gov.uk/docs/cp195_web.pdf

¹⁴ For example OFT, OFWAT, Postcomm

terms of business structure. Alternatively, turnover could be limited to that from reserved legal activities. However, since most legal advice is not reserved, that approach would severely reduce the maximum that could be imposed.

19 By way of example, the following table indicates the UK turnover for five companies¹⁵ and the amount that a penalty of 10% of turnover would be:

	Tesco	Lloyds	Aviva	Clifford Chance	Capita
UK turnover	£42,300m ¹⁶	£23,964m ¹⁷	£14,261m ¹⁸	£1,197m ¹⁹	£2,687m ²⁰
Amount of a 10% fine	£4,230m	£2,396m	£1,426m	£120m	£269m

20 In any event, the concept of turnover is only useful when considering penalties on entities; it is of no use for penalties imposed on managers or employees in an ABS. For individuals the maximum could be a multiple of their income. However, there may also be problems defining income that could reduce the maximum that a LA could impose.

Setting a fixed amount

21 The simplest solution to set a maximum penalty would be to set a fixed amount that would then set the upper limit without any further calculation. It would also provide clarity of the absolute size of the penalty and would have strong deterrence effect through its clarity. However, it would need to be set at such a level so as to ensure that the largest firms were not given disproportionately low penalties compared to the small firms in the market. Setting a fixed amount for individuals would also mean that there were no concerns about defining their income.

Setting the amounts

LSB's preferred option

22 On balance, we prefer the option of setting a high fixed maximum. A high maximum level gives a LA the flexibility to exercise its discretion and judgement in setting a penalty in a way that enables it to take into account the likely wide variation in the outcomes of investigations that it will encounter.

¹⁵ Note: we have no indication that these businesses wish to become ABS. Their inclusion is solely for illustrative purposes.

¹⁶ UK turnover. Source: <http://ar2010.tescopl.com/~media/Files/T/Tesco-Annual-Report-2009/Attachments/pdf/tesco-annualreport.pdf>

¹⁷ Total income, net of insurance claims. Source: http://www.lloydsbankinggroup-annualreport.com/2009/pdfs/Lloyds_Banking_Group_ARA_2009.pdf

¹⁸ Aviva UK Total sales. Source: <http://www.aviva.com/library/reports/2009ar/downloads/aviva-report-2009.pdf>

¹⁹ Revenue Year ended 30 April 2010. Source: http://www.cliffordchance.com/content/dam/cliffordchance/AR2010/Reports/AR10_web.pdf

²⁰ Turnover. Source: http://www.capita.co.uk/investors/Documents/Capita_AR_2009.pdf

We consider that this has the strongest deterrence and the simplicity of the construction means that challenge to the amount of a penalty will be considered in the application of the rules of the LA through the appeal process rather than through administrative appeals on the application of the maximum penalty rules.

- 23 We therefore propose that the maximum financial penalty that can be imposed should be set at £150,000,000 for entities and £50,000,000 for individuals.
- 24 It is our view that the most appropriate outcome is to give licensing authorities the flexibility for penalties to deal proportionately and in a targeted way with a wide range of licence breaches that may be carried out by both individuals and entities in a range of different ABS. When considering individuals we have looked at the miners' compensation claims where one partner is reported²¹ to have earned more than £30m over a five year period on matters that led to him being struck off the roll of solicitors. When considering the entity fine we have looked at the size of firms currently in the market, potential entrants to the market, the deterrence effect of penalties and the size of penalties imposed by other regulators.
- 25 We are aware that the amounts proposed are large. We consider that these will have strong deterrence in the market and avoid situations where any entity or individual may consider "pricing in" non-compliance. Experience from other sectors indicates that the threat of significant penalties does work in terms of deterrence (and regulators do not have to use their powers often) and that in practice the level of penalties is not disproportionate. We consider that small firms should see that setting a high maximum will mean that they are not disadvantaged by their larger competitors' penalties being capped at a disproportionately low level.

1. Do you think that the maximum set by the LSB is sufficiently high to ensure that penalties are able to be proportionately applied by LAs?
2. What are your views on the fixed amounts proposed for entities and individuals? If you disagree with our proposed approach please give your reasons and, if possible, propose an alternative.
3. Do you have any comments on the draft statutory instrument?

²¹ <http://business.timesonline.co.uk/tol/business/law/article4092508.ece>

How to respond

26 The LSB plans to publish all responses received during the consultation period on its website. While the LSB is happy to discuss varying this general policy in individual cases, there is a strong presumption in favour of transparency. It will therefore note publicly that a submission has been received from an identified body which had withheld its consent for publication in the summary of the consultation.

27 We would prefer to receive responses electronically (in Microsoft word or PDF format), but hard copy responses by post or fax are also welcome. Responses should be sent to:

Post: Michael Mackay
Legal Services Board 7th Floor,
Victoria House Southampton Row
London WC1B 4AD

Fax number: 020 7271 0051

Email: consultations@legalservicesboard.org.uk

28 The consultation period will end at **5pm on 24 January 2011**– 33 days from date of publication. In accordance with 205 of the Legal Services Act 2007, you are given notice that any representation about the proposed rules must be made to the Board by the end of this period.

29 We are happy to meet you to discuss your views on the consultation if you would find that helpful. Please send all requests to consultations@legalservicesboard.org.uk.

2011 No.

LEGAL SERVICES, ENGLAND AND WALES

**The Legal Services Act 2007 (Maximum
Penalty for Licensing Authorities) Rules
2011**

<i>Made</i> - - - -	***
<i>Laid before Parliament</i>	***
<i>Coming into force</i> - -	***

The Legal Services Board with the consent of the Lord Chancellor makes the following Rules in exercise of the powers conferred by sections 95(3) and 204(2) of the Legal Services Act 2007⁽²²⁾.

The Legal Services Board has complied with the consultation requirements in section 205 of that Act.

Citation and commencement

1.—(1) These Rules may be cited as the Legal Services Act 2007 (Maximum Penalty for Licensing Authorities) Rules 2011.

(2) These Rules come into force on *[date]*.

Maximum penalty

2. The maximum amount of any penalty which a licensing authority may impose under section 95 of the Legal Services Act 2007 (financial penalties) is—

- (a) in the case of a penalty imposed on a licensed body, £150 million; and
- (b) in the case of a penalty imposed on a manager or employee of a licensed body, £50 million.

Made by the Legal Services Board at its meeting on *[date]*

I consent

Signed by authority of the Lord Chancellor

Name
Parliamentary Under Secretary of State

Ministry of Justice

[Date]

⁽²²⁾ 2007 c.29.

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EXPLANATORY NOTE

(This note is not part of the Order)

This Order specifies the maximum penalty that may be imposed under section 95 of the Legal Services Act 2007 (“the 2007 Act”). That section provides for a licensing authority to impose a penalty on a licensed body, or a manager or employee of a licensed body, in accordance with licensing authority’s licensing rules. Section 83 of, and Schedule 11 to, the 2007 Act makes provision as to the criteria and procedure to be applied in determining whether to impose a financial penalty and the amount of the financial penalty. The maximum amount set by the Order is £150 million for a licensed body and £50 million for an employee or manager of a licensed body.

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Annex B – List of questions

1. Do you think that the maximum set by the LSB is sufficiently high to ensure that penalties are able to be proportionately applied by LAs?
2. What are your views on the fixed amounts proposed for entities and individuals? If you disagree with our proposed approach please give your reasons and, if possible, propose an alternative.
3. Do you have any comments on the draft statutory instrument?

Annex C – Draft impact assessment

Title: Setting the maximum financial penalty for breaches by Alternative Business Structures (ABS) Lead department or agency: Ministry of Justice Other departments or agencies: Legal Services Board	IA No:
	Date: 21/12/2010
	Stage: Development/Options
	Source of intervention: Domestic
	Type of measure: Secondary legislation
	Contact for enquiries: Luke McInerney luke.mcinerney@legalservicesboard.org.uk

Summary: Intervention and Options

What is the problem under consideration? Why is government intervention necessary? This IA concerns the power under section 95 of the LSA 2007, which sets out the circumstances in which a Licensing Authority (LA) can impose a financial penalty on a licensed body - including alternative business structures (ABS). It is a requirement of section 95(3) of the LSA (2007) for the LSB to make rules prescribing the maximum amount of a penalty that can be imposed. The Legal Services Board (LSB), as the oversight regulator for the legal services industry, is required by the LSA 2007 to intervene and set the maximum amount of a financial penalty. Changes to the rules by the LSB are subject to the consent of the Lord Chancellor, as per section 95 (4) of the LSA 2007. Government intervention is needed to prescribe an agreed maximum financial penalty which LAs can impose on ABS entities and individuals working in them.	
What are the policy objectives and the intended effects? The policy objective is to ensure the regulation of legal services remains robust by providing a sufficient financial deterrent against non-compliant behaviour by individuals and entities regulated by Licensing Authorities. This will be achieved by setting an appropriate maximum financial penalty that could be applied to ensure the deterrent effect is sufficient for all ABS firms and individuals, regardless of size. Any penalties actually applied will be proportionate: this policy relates to the theoretical maximum only. The intended effect would ultimately be that consumers remain protected and are confident when accessing the legal services market.	
What policy options have been considered? Please justify preferred option (further details in Evidence Base) The following options have been assessed against the base case of 'do nothing': Option 0: Do nothing (base case); Option 1: Set the maximum financial penalty to a high fixed maximum of £150m for ABS and £50m for individuals Option 2: Set the maximum financial penalty based on a ten per cent proportion of turnover/income Option 1 is the Legal Services Board's preferred option as it allows a Licensing Authority the flexibility to exercise its discretion and judgement in setting a penalty in way that enables it to take into account the likely wide variation in the outcomes of investigations that it will encounter.	
When will the policy be reviewed to establish its impact and the extent to which the policy objectives have been achieved?	It will be reviewed 10/2014
Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review?	Yes

Chief Executive's Sign-off For consultation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Chief Executive:..... Date:.....

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Summary: Analysis and Evidence Policy Option 1

Description: Set the maximum financial penalty to a high fixed maximum of £150m for ABS and £50m for individuals

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low:	High:	Best Estimate:

COSTS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low				
High				
Best Estimate				

Description and scale of key monetised costs by 'main affected groups'

There is a cost of ABS to appeal the decision in terms of legal costs and the costs of the appellate body hearing each case. Given that it is impossible to ex-ante forecast the cost to business of non-compliance and appeals this is a 'theoretical' cost only. There would also be a cost to LAs in determining what constitutes a proportionate penalty which takes account of better regulation principles and the cost of the actual penalty itself which may be up to £150m, as well as overall operational costs of an LA.

Other key non-monetised costs by 'main affected groups'

The primary costs are unquantifiable and relate to the cost of monitoring non-compliance of ABS by LAs. This is non-quantifiable as this is only an element in their overall monitoring activities and cannot be differentiated from it.

BENEFITS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low				
High				
Best Estimate				

Description and scale of key monetised benefits by 'main affected groups'

Other key non-monetised benefits by 'main affected groups'

A high fixed maximum financial penalty has the advantage of strengthening the enforcement and compliance regime of LAs thereby deterring non-compliant behaviour, risk of 'gaming' by firms, and raising consumer and business confidence. These non-monetised benefits are diffuse and have a positive spill-over effect throughout the regulated legal services market with consumers benefiting from more safeguards and better functioning market as firms have confidence that non-compliant firms will face penalties.

Key assumptions/sensitivities/risks

Discount rate (%)

It is assumed that the actual penalty imposed would in all cases be proportionate. The risk of disproportionate fines being set in the first place is offset by the publication of LAs' policy approach to non-compliance as part of their initial application in becoming a LA which is scrutinised and assessed by the LSB in terms of its approach and compliance with the better regulation principles of proportionality and reasonableness. Also, firms have the right of appeal to an appellate body on the grounds of reasonableness regarding the size and nature of the financial sanction levied, providing a mechanism for the fine to be challenged.

Impact on admin burden (AB) (£m):			Impact on policy cost savings (£m):	In scope
New AB:	AB savings:	Net:	Policy cost savings:	Yes/No

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Summary: Analysis and Evidence Policy Option 2

Description: Penalty based on a ten per cent proportion of turnover/income

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low:	High:	Best Estimate:
COSTS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)		Total Cost (Present Value)
Low					
High					
Best Estimate					
Description and scale of key monetised costs by 'main affected groups'					
Other key non-monetised costs by 'main affected groups'					
It is not possible to quantify the costs for the option of having a penalty based on a proportion of turnover over/annual income. However it can be envisaged that there would be some cost of compliance for LAs given that they would have to ascertain the annual turnover/income of ABS/individual in order to impose the correct penalty. Also, knowledge of the maximum penalty may remove the efficacy of deterrence and substitutes it with certainty around the amount of the penalty that a LA can impose.					
BENEFITS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)		Total Benefit (Present Value)
Low					
High					
Best Estimate					
Description and scale of key monetised benefits by 'main affected groups'					
Other key non-monetised benefits by 'main affected groups'					
Other key non-monetised benefits include the indirect benefit of having a penalty based on annual turnover/income which is consistent with other penalty regimes based on turnover. This approach could create some consistency for firms and also, presumably, reduce administrative and resource costs to the LAs' monitoring of compliance behaviour.					
Key assumptions/sensitivities/risks					Discount rate (%)
It is assumed that while there is the possibility of having a penalty based on a multiple of annual income, a penalty based on having a fixed portion of income/turnover has the potential to not be the most robust method of deterrence as firms would effectively know the amount they could be fined. Also, a penalty based on income/turnover would have the effect of removing the discretion of LAs to impose a penalty which they think is commensurate with the level and degree of non-compliant behaviour.					
Impact on admin burden (AB) (£m):			Impact on policy cost savings (£m):		In scope
New AB:	AB savings:	Net:	Policy cost savings:		Yes/No

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Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?	England and Wales				
From what date will the policy be implemented?	06/10/2011				
Which organisation(s) will enforce the policy?	Licensing Authorities				
What is the annual change in enforcement cost (£m)?	Negligible				
Does enforcement comply with Hampton principles?	Yes				
Does implementation go beyond minimum EU requirements?	Yes				
What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent)	Traded:		Non-traded:		
Does the proposal have an impact on competition?	No				
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?	Costs:		Benefits:		
Annual cost (£m) per organisation (excl. Transition) (Constant Price)	Micro	< 20	Small	Medium	Large
Are any of these organisations exempt?	No	No	No	No	No

Specific Impact Tests: Checklist

Does your policy option/proposal have an impact on...?	Impact	Page ref within IA
Statutory equality duties	No	15
Economic impacts		
Competition	Yes	15
Small firms	No	15
Environmental impacts		
Greenhouse gas assessment	No	16
Wider environmental issues	No	16
Social impacts		
Health and well-being	No	16
Human rights	No	16
Justice system	No	16
Rural proofing	No	16
Sustainable development	No	16

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Evidence Base (for summary sheets) – Notes

References

No.	Legislation or publication
1	Legal Services Act (2007)
2	LSB Consultation Paper Approaches to Licensing
3	LSB Response to Consultation
4	

Evidence Base

Annual profile of monetised costs and benefits* - (£m) constant prices

	Y ₀	Y ₁	Y ₂	Y ₃	Y ₄	Y ₅	Y ₆	Y ₇	Y ₈	Y ₉
Transition costs										
Annual recurring cost										
Total annual costs										
Transition benefits										
Annual recurring benefits										
Total annual benefits										

* For non-monetised benefits please see summary pages and main evidence base section

Evidence Base (for summary sheets)

1. Introduction

Background

1. 1 The Legal Services Board (LSB) was created by the Legal Services Act (LSA 2007). The LSB's mandate is to ensure that regulation in the legal services industry is carried out in manner that is consistent with the public interest and that the interest of consumers is central in policy making. It is charged with the responsibility of overseeing legal regulators and ensuring that its activities reflect the regulatory objectives set out in the LSA 2007.
1. 2 The LSA 2007 will enable the operation of Alternative Business Structures (ABS). This will help open up the legal services market to competition and to new ways to structure legal businesses, forming part of the wider package of deregulation which is the basis of the LSA 2007. ABS will be permissible from October 2011 and will allow law firms and individuals to explore new ways of organising their businesses to be more cost-effective, permit different kinds of lawyers and non-lawyers to work together, and allow for external investment.
1. 3 Currently operating legal service providers are regulated by 'Approved Regulators' (ARs). However, ABS firms will not fall within the jurisdiction of ARs, and will instead be regulated by Licensing Authorities (LAs). In principle, a body can be both an AR and LA. As the oversight regulator, the LSB oversees both ARs and LAs.
1. 4 There is already a set of rules prescribing the maximum financial penalty that ARs can impose for non compliance with its regulatory rules. In the same way, rules relating to the maximum financial penalty that LAs can impose for non-compliance must also now be made.
1. 5 The LSA 2007 sets out how the LSB can make rules prescribing the maximum amount of a financial penalty that can be imposed by a Licensing Authority. The LSA 2007 makes provision for the Approved Regulators to apply to the LSB to become designated Licensing Authorities. As Licensing Authorities they may issue licences to legal services business that have some element of non-lawyer ownership commonly referred to as ABS.
1. 6 Licensing Authorities will need to provide the LSB with their proposed enforcement policy as part of the general application to become Licensing Authorities. The LSB expects that this information would be published, providing clear information to potential ABS as to how a Licensing Authority will approach compliance and enforcement. Publication of penalties can serve to deter future non-compliance and provide important information to other market participants in terms of the rationale for the size of financial penalty imposed and the scope of enforcement activity.
1. 7 LAs must have regard to the better regulation principles of proportionality and this will apply to all of their regulatory activities including, but not limited to, imposition of penalties, and modification of licensing conditions.
1. 8 The proposals assessed in this Impact Assessment (IA) relate to policy options concerning the choice of the maximum financial penalty that LAs can impose on an ABS firm or individual manager or employee, in the event of non-compliance with its rules and regulations.

Defining the maximum

1. 9 The proposal for a maximum financial penalty of a high fixed maximum of £150m for ABS and £50m for individuals sets a high ceiling to which a LA may impose a financial penalty for non-compliance of licensing rules. This figure is deliberately set as a high maximum in order to deter such behaviour, however it should be emphasised that this figure is an absolute figure only and, depending on the nature of a breach, a LA would impose a penalty commensurate with the seriousness of the non-compliant behaviour – ie. a financial penalty would not necessarily be imposed at the highest fixed maximum, but rather would be proportional.
1. 10 In formulating a maximum financial penalty for ABS and individuals, the LSB has drawn from other similar penalties in the legal services industry. For example the Solicitor Disciplinary Authority has the power to impose an unlimited fine for disciplinary breaches. In terms of maximum financial penalties in other industries, sections 66, 91, 123, and 206 of the Financial Services and Markets Act 2000 gives discretion to impose a penalty of such amount as considered appropriate by the Financial Services Authority. Similarly, the Money Laundering Regulations 2007, the Transfer of Funds (Information on the Payer) Regulations 2007, the Regulated Covered Bonds Regulations 2008, and the Payment Services Regulations 2009, give

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a similar power to the Financial Services Authority. This power is then limited by the Financial Services Authority's current enforcement policy which, for example, in many circumstances sets 20% of a firm's income as the maximum amount which may be imposed as a penalty.

Problem under consideration

1. 11 Given that creation and regulation of ABS will not come into force until after the commencement of Part 5 of the LSA, scheduled for October 2011, an appropriate enforcement framework is needed for Licensing Authorities prior to this date. The LSA act requires the LSB (LSA s.95(3)) to make rules by statutory instrument (LSA s.206(6)) that prescribe the maximum penalty that may be imposed by a Licensing Authority on an ABS. This will ensure that ABS and individuals in them will have a strong incentive to comply with the licensing rules and will afford greater protection to consumers.
1. 12 The maximum amount of a penalty is only what Licensing Authorities can impose on ABS's in a worst case scenario for non-compliance. In discharging its functions to Licensing Authorities the LSB has to adhere to the regulatory objectives set down in the LSA 2007 and also the principles of transparency, accountability, proportionality, consistency and a targeted approach to regulation.
1. 13 The LSB plans for ABS to be permitted from October 2011. In view of this it is necessary to have a maximum financial penalty prescribed and the requisite regulatory frameworks and systems in place before this date in order to ensure that Licensing Authorities have certainty regarding their enforcement powers in the event of non-compliance.

Economic rationale

1. 14 The conventional economic approach to government intervention to resolve a problem is based on efficiency or equity arguments. The Government may consider intervening if there are strong enough failures in the way markets operate (e.g. monopolies overcharging consumers) or if there are strong enough failures in existing government interventions (e.g. waste generated by outdated rules). In either case the proposed intervention should avoid creating a further set of disproportionate costs and distortions. The Government may also intervene for equity (fairness) and distributional reasons (e.g. to reallocate goods and services from one group in society to another).
1. 15 Intervention in this case would be justified primarily on efficiency grounds. The deterrent effect provided by introducing the possibility of a financial penalty for non compliance should increase overall compliance by ABS firms. This would generate a set of efficiency benefits, including that the regulation of the legal services market remains robust and efficient. Consumers of legal services will ultimately benefit from the proposal through a higher quality of service provided by ABS firms, and potentially through increased confidence when accessing the legal services market.
1. 16 It is noted that the proposal would impose some costs on ABS firms - for example, one response to the threat of a financial penalty may be to devote more resources to ensuring compliance with the relevant regulations. The threat of a financial penalty also increases the level of risk within which firms operate, which is likely to involve a further welfare cost. These costs may be passed on to the consumers of legal services in the form of higher prices. The rationale therefore hinges on the fact that any penalty actually imposed will be proportionate to the type of firm and offense in each specific incident. This should minimise these costs.
1. 17 The proposal may also be justified on equity grounds as the fixed high maximum for ABS is set at a level sufficiently high enough (ie. maximum of £150m) that the sanctions of an unlimited amount currently set for solicitor firms by the SDT so is unlikely to have negative equity effects between the penalty regime of ARs and LAs.

Policy Objectives

1. 18 The principal policy objective is to set a maximum financial penalty at an appropriate level to provide a sufficient deterrent effect so that consumers are ultimately protected through a robust regulatory regime that is enforced by Licensing Authorities. Related to this is the necessity for Licensing Authorities to have the discretion and flexibility to impose a penalty that is not so high to put unreasonable compliance costs on business but which is sufficient to deter non-compliance with the relevant regulations. The regulatory objective of 'protecting and promoting

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the public interest', to which the LSB has regard when discharging its functions, would also be promoted through having robust non-compliance systems and appropriate penalties in place.

Affected stakeholder groups, organisations and sectors

1. 19 The following individuals/sectors are likely to be affected by the proposals:
 - *Licensing Authorities*: LAs will enforce licensing rules and monitor compliance against their licensing rules. The Solicitors Regulation Authority and Council for Licensed Conveyancers are expected to be among the first LAs.
 - *Alternative Business Structures*: All ABS will be regulated by LAs and any non-compliant behaviour liable to incur a financial penalty
 - *Providers of legal services*: current providers of legal services will be affected as robust financial penalties for non-compliance by ABS firms will eliminate any potential competitive advantage that an ABS firm may enjoy if the proposal were not implemented.
 - *Consumers of legal services*: Consumers will have additional protections with the setting of a high fixed maximum penalty. This approach to dealing with non-compliance will reduce the incentive to not comply with the relevant regulations, which are in place to protect consumers.
 - *Legal Services Board*: will ensure that LAs' licensing rules include appropriate compliance and enforcement arrangements to use properly the financial penalty powers.
 - *The appellate body*: As an additional safeguard, the LSA 2007 also sets out the ground on which ABS entities and individuals are able to appeal to an appellate body against the decision of a Licensing Authority to impose a penalty or its quantum. The methodology of apportioning these costs is being developed with the LSB, the Tribunal Service and potential LAs.
 - *HMCS*: Any changes to current policy that change the volume of cases progression to court would impact on the court service.
1. 20 The scope of this IA is limited solely to the amount of the maximum financial penalty that Licensing Authorities can impose on ABS for non-compliant behaviour. This IA is part of the overall implementation plan for ABS; the proposed regulation will be enforced throughout England and Wales.

2. Costs and benefits

2. 1 This Impact Assessment identifies impacts on individuals, groups and businesses in the UK, with the aim of understanding what the overall impact to society might be from implementing these options. The costs and benefits of each option are compared to the do nothing option. Impact Assessments place a strong emphasis on valuing the costs and benefits in monetary terms (including estimating the value of goods and services that are not traded). However there are important aspects that cannot sensibly be monetised. These might include how the proposal impacts differently on particular groups of society or changes in equity and fairness, either positive or negative.

Assumptions

2. 2 The following assumptions have been used:
 - Underlying the analysis regarding different options of imposing a maximum financial penalty for non-compliant ABS is the assumption that the introduction of ABS will be taken-up by a sufficient volume of firms to warrant enforcement and compliance structures;
 - Assumed that Licensing Authorities are competent to regulate ABS as demonstrated through their application process to the LSB;
 - Assumed that the uptake of ABS firms creates a more competitive market in the provision of reserved legal services after ABS firms are permissible (October 2011);²³
 - Assumed that ABS firms will compete for the provision of legal services with existing legal service providers.

²³ A full Impact Assessment detailing the possible uptake scenarios for ABS and their expected impact will be produced separately to this Impact Assessment.

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- Assumed that appropriate criteria would be put in place to so that a **proportionate** financial penalty is always imposed for each case of non-compliance. This would allow both Licensing Authorities and if required the appellate body to take a consistent approach; and
- Assumed that an appellate body will be in place to ensure that ABS are able to make appeals.
- Assume that the proposed penalty regime is not set too high that it deters firms from becoming ABS. Countervailing this risk is that strong deterrence should encourage compliant firms to have confidence in entering and operating in the market as any perceived competitive gain from non-compliance would be removed, facilitating a level playing field for firms.

Option 0: Base case (do nothing)

- 2.3 Under the do nothing option, there would be no framework in place which would prescribe a maximum financial penalty on non-compliant ABS when they are introduced in October 2011. Section 95 (3) of the LSA 2007 requires the LSB to make rules prescribing the maximum amount. Therefore, the do nothing base case is presented as a hypothetical option only.
- 2.4 Because the do nothing option is compared against itself its costs and benefits equate to zero, as is its Net Present Value (NPV).²⁴

Option 1: Setting a high fixed maximum of £150m for ABS and £50m for individuals

Description

- 2.5 This option sets a high fixed maximum financial penalty that Licensing Authorities can impose on ABS for non-compliant behaviour. It is not envisaged that the maximum financial penalty would always be applied but used as the upper limit against which to assess the appropriateness of a proposed penalty.
- 2.6 The requirement for a Licensing Authority is that it must act proportionately according to the particular circumstances of the case. The way in which this would be monitored and enforced will be outlined in the licensing rules of individual Licensing Authorities, having regard to the better regulation principles of proportionality and accountability. The licensing rules set by Licensing Authorities will be scrutinised by the LSB at the time of their application for designation. This ensures that these rules are consistent and reasonable in their approach to levying financial penalties.

Costs of Option 1

- 2.7 There are likely to be one off adjustment costs faced by all affected parties. However, these costs are not expected to be significant.

Alternative Business Structures

- 2.8 The proposal is likely to impose costs on ABS firms. First, those firms which are non-compliant would have to bear the costs of the financial penalty. In instances where an ABS has a penalty imposed on them, in addition to the financial costs they would also face reputational damage. This reinforces the financial incentives provided by the penalty itself.
- 2.9 Second, the existence of financial sanctions will increase the risk in which ABS firms operate. There may also be uncertainty about the magnitude of what financial penalty would actually be imposed (as the proposal relates to the maximum only). This increased risk represents a cost for ABS firms.
- 2.10 Finally, a result of the proposal is likely to be that ABS firms spend extra resources to try to ensure compliance with the relevant regulations (in order to reduce the risk of incurring a financial penalty). These compliance costs borne by ABS as a result of a high maximum penalty could be significant.

²⁴ The Net Present Value (NPV) shows the total net value of a project over a specific time period. The value of the costs and benefits in an NPV are adjusted to account for inflation and the fact that we generally value benefits that are provided now more than we value the same benefits provided in the future.

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Providers of legal services

2. 11 The LSA 2007 sets out the ground on which ABS entities and individuals are able to appeal to an appellate body against the decision of a Licensing Authority to impose a penalty or its quantum. By enabling financial penalties to be imposed, the proposal is therefore likely to result in additional costs associated with appeals. The methodology of apportioning these costs is being developed with the LSB, the Tribunal Service and potential LAs.
2. 12 In principle, some of the funding for the appellate body (such as set up costs and fixed running costs) may be paid by the legal services industry as a whole, including existing legal service providers. The proposal may therefore result in some additional costs for existing legal service providers. These costs will depend in part on how many appeals are lodged, and in part on the funding arrangements developed.

Consumers of legal services

2. 13 As outlined above, the proposal is likely to result in additional compliance costs for ABS firms. These costs may be passed on to consumers in the form of higher prices. Similarly, any costs associated with appeals to an appellate body, and any costs borne by LAs which are passed on to ABS firms may also be ultimately passed on to the consumers of legal services.

Licensing Authorities

2. 14 Licensing Authorities would incur some ongoing monitoring and enforcement costs, particularly in instances when it would have to impose penalties. These costs are likely to include assessing the extent of non-compliance and calculating the appropriate and proportionate level of financial penalty on a case by case basis.

Appellate body and HMCS

2. 15 As outlined above, there are likely to be costs associated with appeals to an appellate body in relation to any financial penalties imposed by LAs. The methodology of apportioning these costs is being developed with the LSB, the Tribunal Service and potential LAs.
2. 16 HMCS may incur costs in terms of resource if there are any appeals by ABS. The volumes of appeals depend on the level of non-compliance and whether the penalties imposed are perceived to be proportionate. However, any increase in tribunal volumes should in theory have no net financial impact on HMCS given court fees should adjust to cover any costs incurred in each case.

Benefits of Option 1

Consumers of legal services

2. 17 Consumers of legal services would benefit from this option. The ability of Licensing Authorities to impose penalties in line with the circumstances of each case should provide an effective deterrent against non-compliance by ABS with the relevant regulations. The regulatory frameworks which govern the legal services market would remain robust, which would benefit consumers of legal services. Consumers would benefit directly if the quality of legal services increased as a result, and consumers may also benefit if they have increased confidence when accessing the legal services market.

Existing providers of legal services

2. 18 It is assumed that existing providers will compete with ABS firms for the provision of legal services. If this is the case, in the absence of the proposal ABS firms would have a competitive advantage given they would not face the threat of financial penalty for non-compliance. As outlined above, the threat of financial penalties is likely to involve firms incurring additional compliance costs, which are ultimately passed on to consumers in the form of higher prices. Existing providers (ie solicitors) regulated by ARs can face fines for non-compliance by the SDT which can levy an unlimited penalty for providers of legal services.

Government Consolidated Fund

2. 19 Licensing Authorities do not financially benefit from the imposition of a penalty as the proceeds of financial penalties are paid into the Government's Consolidated Fund. This removes any perverse incentives for Licensing Authorities to raise revenue through imposing penalties. The proposal may therefore benefit taxpayers if it provides additional revenue for Government.

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Net Impact of Option 1

2. 20 It has not been possible to quantify the impacts outlined above, in part as that these will be heavily dependent on behavioural responses and market conditions. Based on the impacts identified, the proposal is expected to provide a net benefit.

Option 2: Set the maximum financial penalty at ten per cent of annual turnover / income

Description

2. 21 This option discusses whether the maximum penalty that Licensing Authorities can impose on ABS entities and individuals for non-compliant behaviour should be set at ten per cent of their turnover and income respectively. As under Option 1, it is not envisaged that the maximum financial penalty would always be applied but used as the upper limit against which to assess the appropriateness of a proposed penalty.

Costs of Option 2

2. 22 There are likely to be one off adjustment costs faced by all affected parties. However, these costs are not expected to be significant.

Alternative Business Structures

2. 23 The costs are likely to be similar to those canvassed under option 1. The proposal is likely to impose costs on ABS firms. First, those firms which are non-compliant would have to bear the costs of the financial penalty which is calculated as a proportion of their turnover. In instances where an ABS has a penalty imposed on them, in addition to the financial costs they would also face reputational damage. This reinforces the financial incentives provided by the penalty itself.
2. 24 The existence of financial sanctions will increase the risk in which ABS firms operate. There may also be uncertainty about the magnitude of what financial penalty would actually be imposed (as the proposal relates to the maximum of ten per cent of annual turnover but could be less). This increased risk represents a cost for ABS firms.
2. 25 A result of the proposal is likely to be that ABS firms spend extra resources to try to ensure compliance with the relevant regulations (in order to reduce the risk of incurring a financial penalty).

Providers of legal services

2. 26 As for Option 1, providers of legal services may suffer some costs from this proposal. Due to the uncertainty of the level of financial penalty for non-compliance, firms which may have applied to become ABS may not do so. The maximum level of financial penalty may act as a barrier for firms to enter the ABS market, and may result in lower income and profits for these firms. However, this analysis assumes that there is sufficient take up of ABS by firms.
2. 27 In addition, some of the funding for the appellate body (such as set up costs and fixed running costs) will be paid by the industry as a whole, the cost of which would depend in part on how many appeals are lodged, and may be an additional cost to providers of legal services.

Consumers of legal services

2. 28 Consumers may incur costs with this proposal. As outlined in Option 1, any penalty imposed on ABS may be passed onto consumers.

Appellate body

2. 29 The costs to the appellate body are likely to be the same as for Option 1.

Licensing Authorities

2. 30 Licensing Authorities would incur some ongoing monitoring and enforcement costs in instances when it decided to investigate a potential licence breach and impose a penalty.
2. 31 There would also be a cost in obtaining the information necessary to work out the maximum penalty that could be imposed and this would vary from case to case. The potential complexity of defining turnover and income may make decisions more susceptible to challenge which would in turn increase costs.

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2. 32 A disadvantage of moving a penalty based on turnover is defining what the appropriate turnover should be. In this case, should a Licensing Authority wish to set a penalty at the top of the range there would be strong incentives for the ABS to argue that the calculation of turnover was incorrect and the penalty was unlawful. Also, if the maximum amount were set as a proportion of total turnover of the entity then this may need to include information on global turnover (for larger firms with offshore subsidiaries, etc) and which may be difficult and costly to obtain. UK based turnover could be easier to assess in this respect, but this could create perverse incentives in terms of business structure.

HMCS

2. 33 HMCS may incur costs in terms of resource if there are any appeals by ABS. The volumes of appeals depend on the level of non-compliance and whether the penalty is deemed to be proportionate.

Benefits of Option 2

Consumers of legal services

2. 34 Consumers of legal services would benefit from this option. First, the ability of Licensing Authorities to impose penalties up to a maximum of a significant proportion of income/turnover would be a deterrent against non-compliance by ABS.
2. 35 Second if the effectiveness of the regulatory system is improved, more firms may be encouraged to enter the market, again benefitting consumers. In both cases the penalty will reflect the specific circumstances of the case.

Alternative Business Structures

2. 36 ABS would benefit from the transparency with which penalties would be imposed. This would also benefit ABS that are compliant with regulations as they would not be disadvantaged by firms not employing unfair methods of business and also not punished appropriately.

Providers of legal services

2. 37 As outlined in Option 1, providers of legal services would benefit from the positive spill-over effect of appropriate sanctions for noncompliance, which should in theory instil greater confidence in new businesses wanting to enter into the legal services market and / or apply for ABS, and greater consumer confidence in legal services which may result in increased demand.

Licensing Authorities

2. 38 Licensing Authorities may benefit from this proposal. The appeals process by which a third party is able to scrutinise decisions made by Licensing Authorities may again act as a feedback loop in assisting Licensing Authorities with an appropriate penalty to impose.

Government Consolidated Fund

2. 39 Any financial penalty imposed on an ABS by Licensing Authorities is paid into the Consolidated Fund. There is therefore no incentive on the LSB to impose a large penalty other than the penalty should be an incentive to change behaviour.

Net impact of Option 2

2. 40 The result of this proposal is that a maximum of financial penalty expressed as a proportion of income or turnover on ABS entities is likely to be a deterrent to non-compliant behaviour, as the level of penalty would take into account the size of the firm.
2. 41 As with Option 1, it has not been possible to quantify these impacts given that these will be heavily dependent on behavioural responses and market conditions.

Summary of Options

2. 42 Option 1 proposes to set a high fixed maximum as the maximum financial penalty that Licensing Authorities can impose on ABS. The advantages are that all factors of the ABS and nature of non-compliance would be taken into account, resulting in a proportionate level of financial penalty. Having a high maximum also provides a credible threat to ABS that the punishment for non-compliance can be used to reflect the nature of non-compliance.

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2. 43 Option 2 is likely to be significantly more complex for LAs and those regulated as definitions of turnover and income are complex to set out and are therefore more likely to be challenged.
2. 44 The LSB's preferred option therefore is Option 1. It appears to be in the best interest of the duties under the regulatory objectives.

3. Enforcement and Implementation

3. 1 The assumption for the proposal is that it will be implemented prior to the scheduled commencement date for part 5 of the LSA in October 2011. The enforcement frameworks need to be in place before then in order to give clarity to firms wishing to become ABS and also for Approved Regulators to take account of the enforcement framework when making their applications to be designated as Licensing Authorities.
3. 2 As the oversight regulator of the legal services market, the LSB will be monitoring the changes as set out in the Post Implementation Review Plan below.

4. Specific Impact Tests

Statutory Equality Duties

4. 1 The setting of a high fixed maximum financial penalty is not viewed as having a negative impact on disability, gender, gender identity, and race. Setting a high fixed maximum financial penalty will significantly strengthen the compliance and enforcement framework which will contribute to a well functioning market and better outcomes for all consumers of legal services. This situation is likely to lower the barriers to entry into the legal services market, increasing competition and shaping a market that is more consumer focused and price competitive. An outcome of this is better access to legal services by all types of consumers as a more effective market would deliver legal services at a competitive price. Efficiently functioning markets also encourage innovation over time and other dynamic benefits realised for consumers include: allocative efficiency, responsive supply-side matching to new demand, better tailored products (niche markets) and enhanced productivity amongst suppliers. All consumers are likely to benefit from these market-wide benefits which will positively impact on diversity and access to justice and legal services more broadly.

Competition

4. 2 Setting a high fixed maximum financial penalty places an absolute ceiling on the ability of a LA to levy a financial penalty on a non-compliant ABS firm at £150m while under current arrangements the SDT can impose an unlimited penalty for existing providers (ie solicitors) of legal services regulated by ARs. In this context, an improved regulatory environment with the setting of a high fixed maximum financial penalty with stronger enforcement and compliance monitoring sends signals to market participants and can shape firm-specific behaviour. A market with significantly strengthened compliance and enforcement framework is attractive for both incumbent and new firms and can reduce the transaction cost of new entry, which itself raises productivity as encourages competitive pricing of legal service products.
4. 3 Improved regulation and greater competition are both important elements of delivering better access to justice for consumers through competitively priced legal services, as well as delivering market-wide benefits of encouraging innovation and improving allocative efficiency of the legal services market.

Small Firms Impact Test

4. 4 The preferred option of introducing a high fixed maximum financial penalty should not adversely affect small firms. In line with the foregoing analysis, the LSB takes the view that an improved regulatory environment which encourages a more competitive and open market is a positive development for small firms. For example, there is a payoff for small firms in terms of a better regulated market as this promotes consumer protection and a level playing field given that any penalty imposed would depend on the nature of the breach. By having robust and meaningful deterrence of non-compliance compels higher rates of small business compliance. This is likely to be, in aggregate terms, beneficial for the market as compliant behaviour creates a level playing field and attracts new entrants which deepens and broadens the scope of services offered. Given

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that any financial penalty would be imposed with an eye to proportionality – depending on the nature of the breach – a LA has the discretion to impose a fine up to the high fixed maximum financial penalty. To this end, considerations such as the size of the firm and nature and level of the breach gives LAs discretion to impose a fine that is proportional and, in the case of a small firm, a penalty that is reasonable in view of the firm's size, etc.

Carbon Assessment

4. 5 We do not anticipate any significant carbon impacts as a result of these proposals.

Other Environment

4. 6 We do not anticipate any other environmental impacts as a result of these proposals.

Health Impact Assessment

4. 7 We do not anticipate any direct health impact from these proposals.

Human Rights

4. 8 These proposals are compatible with the Human Rights Act 1998.

Justice Impact Test

4. 9 The justice impacts of these proposals have been outlined in the main body of this impact assessment. The establishment of an appellate body, is the subject of a separate impact assessment and under current proposals by the LSB.

Rural proofing

4. 10 We do not anticipate and specific or different impact in rural areas as a result of these proposals.

Sustainable Development

4. 11 These proposals are consistent with the principles of sustainable development.

Privacy Impact Test (an MoJ Specific Impact Test)

4. 12 These proposals will not have an impact on privacy.

Annex A: Post Implementation Review (PIR) Plan

Basis of the review:

The basis of the review for imposing a high fixed maximum financial penalty would be part of a broader post implementation review of ABS. Since ABS are not due to be allowed before October 2011, any PIR would take place some time after that. .

Review objective:

The objective of a review would be to determine whether the regulatory objectives set out in the LSA (2007) have been met in relation to the introduction of ABS. Specifically, the post-implementation review would assess the extent to which LAs have imposed penalties and the frequency of appeal to the appellate body on the basis that such penalties were 'unreasonable'. A review would investigate how the objectives of a high fixed maximum financial penalty such as proportionality would fit the circumstance of when a penalty has been imposed and how well they have been met, etc.

Review approach and rationale:

The review would be part of a wider review of the introduction of ABS and to this end would look across to how the market had changed with the introduction of ABS and provide an in-depth evaluation of the appropriateness of the regulatory structure.

Baseline:

The base line is the current regulatory structure of the market prior to commencement of Part 5 of the Legal Services Act 2007 currently anticipated to be October 2011.

Success criteria:

The achievement of the policy objectives would include the operation of LAs and their ability to impose penalties on non-compliant ABS, and the establishment of an ABS appellate body. Any review of the regulation would take into account the effectiveness of a high fixed maximum financial penalty in terms of deterring non-compliance and, in circumstances when it's imposed, its proportionality and appropriateness. The chief criteria for establishing its success is to ascertain whether a high fixed maximum financial penalty contributes to a strengthened and robust regulatory regime that has the confidence of consumers and legal service providers.

Monitoring information arrangements:

Given that penalties will be imposed by LAs, most monitoring will occur at this level. LAs are required to monitor ABS under their licensing rules and to this end are charged with information collection and monitoring as part of their oversight of ABS as Licensing Authorities. Relevant information for a post-implementation review could also be derived from the appellate body as this body would handle appeals in relation to the reasonableness of a penalty.

Reasons for not planning a PIR:

N/A