

Investigation into the cost of regulation in the market for legal services in England and Wales: scope of project strand two

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Overview

Objective of project

1. The hypothesis that regulation of legal services in England and Wales is too costly is regularly put forward by different stakeholders in the market¹. This project will gather evidence to test the validity of this hypothesis.
2. Our aim with this project where the Legal Services Board (LSB) will investigate the drivers of costs by gathering evidence is:
 - to establish an evidence base for policy makers and regulators to base future work on; and
 - to identify any common areas where providers may be able to reduce their compliance costs.
3. The LSB's 2014/15 [business plan](#) states that the cost of regulation project will focus on the following four areas:
 - Direct regulatory costs imposed on regulated individuals and businesses. This includes only involuntary costs, not those taken on voluntarily in order to gain some commercial benefit.
 - Costs imposed by the regulatory framework, including the LSB and Legal Ombudsman. This includes any duties and responsibilities set out in the Legal Services Act which creates costs for providers and regulators.
 - Indirect regulatory costs faced by regulated individuals and businesses in complying with legal services regulation. Direct regulatory costs involve a fee being paid to a regulator. Indirect costs are those where no direct fee is involved e.g. complying with diversity requirements.
 - Regulatory burdens imposed by professional bodies on regulated individuals and businesses. This encompasses the Act's permitted purposes, where professional bodies such as the Law Society, Bar Council and Chartered Institute of Legal Executives still require compulsory payment from the authorised providers for certain non-regulatory functions.

Scope

4. The scope of this project is necessarily broad. However, in order to keep the project manageable, clear demarcation of the work to be undertaken is needed.

¹ For example by the [Law Society](#); the [Bar Standards Board](#); the [City of London Law Society](#); and the [Bar Council](#).

This is also necessary to adhere to the project timetable and in particular our commitments in the [business plan](#)².

5. This project has two strands. The first strand investigates the costs of regulation perceived by legal service providers. Please see earlier [scoping paper](#) for more details on this strand of work. The second strand explores the costs of the approved regulators and the LSB.
6. To reach the project's objectives the LSB will follow a threefold research approach. For the first strand we will conduct a large scale survey, providing a snapshot of full compliance costs of regulation perceived by providers as well as a snapshot of incremental costs of regulation faced by providers (i.e. what they do in addition to good practice). This will be followed by a series of in depth interviews of entities and individuals, providing a more detailed snapshot of full compliance costs and any incremental cost of regulation faced by providers.
7. The second work strand will comprise of a benchmark analysis of the regulatory and non-regulatory functions of the approved regulators funded via the practising certificate fees. It will also benchmark the functions of the LSB. This strand may include expenditure of regulators across different areas over time.

Project strand 2: costs of the regulators

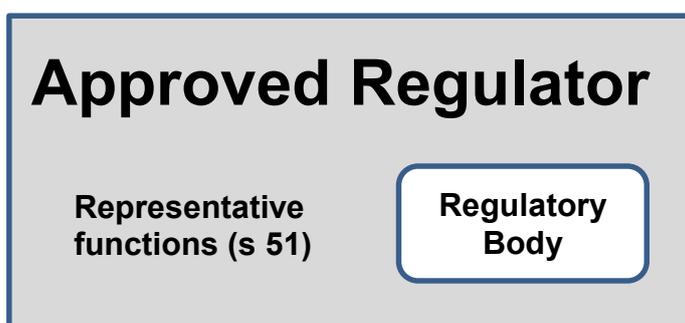
Overview

8. The main focus of this strand of the project is a high level exploration of the spending of the LSB and of the approved regulators. For the LSB we will do this by examining how we spend the money received from the LSB levy which all regulators pay. For the approved regulators, we will analyse how the money raised by the practising certificate fee (PCF) and any other income is used to cover regulatory cost and wider representative cost as allowed under [section 51](#) of the Legal Services Act.
9. The intention is to explore the spend of the approved regulators and the LSB on a number of functions, and to compare their spend on these functions with appropriate benchmarks (for example from other regulated sectors and the wider economy) to establish if there are any outliers. Outliers may indicate an over or underspend on certain areas.

² The business plan allows for a very broad scope to this project (at p19-20): "In 2014/15 we will examine the various components of regulation that place a burden on the legal sector in order to identify potential cost reduction and simplification measures... The ultimate objective is to produce a set of recommendations for reducing the overall cost of regulation, which can be implemented across the regulatory community in the future."

In scope

10. To determine the scope of this strand of the project we begin by determining the bodies for review. The scope covers the LSB and the approved regulators as set out below. Most of the approved regulators are the representative body for their part of the profession, delivering regulatory functions through an independent regulatory body. Two – CLC and MoF do not have a representative function..



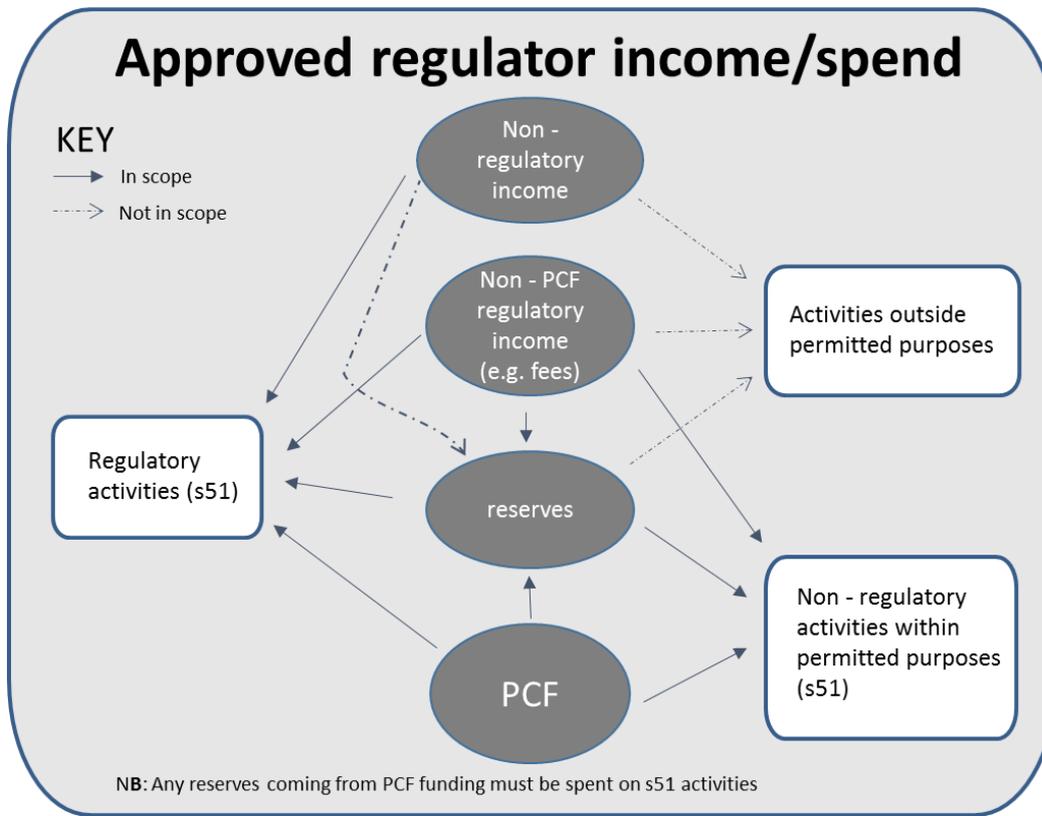
11. In addition to the LSB, which oversees the approved regulators the bodies for review are³:

| Approved Regulators | Independent Regulatory Body |
|--|---|
| 1. <u>Law Society</u> | <u>Solicitors Regulation Authority</u> |
| 2. <u>Bar Council</u> | <u>Bar Standards Board</u> |
| 3. <u>Chartered Institute of Legal Executives</u> | <u>ILEX Professional Standards Limited</u> |
| 4. <u>Council for Licensed Conveyancers</u> (regulatory body for Licensed Conveyancers, no representative functions) | |
| 5. <u>Chartered Institute of Patent Attorneys (CIPA)</u> | <u>Intellectual Property Regulation Board</u> |
| 6. <u>Institute of Trade Mark Attorneys (ITMA)</u> | (Regulatory body for both CIPA and ITMA) |
| 7. <u>Association of Costs Lawyers</u> | <u>Costs Lawyer Standards Board</u> |
| 8. <u>Master of the Faculties</u> (regulatory body for Notaries, no representative functions) | |

12. For these eight approved regulators we are interested in the cost of their regulatory functions and any representative functions funded as permitted

³ ICEAW, ACCA and ICAS are out of scope of this review. Please see paragraph 16 for more details.

purposes via the practising certificate fee. We are also interested in regulatory activities funded by any other income than the practising certificate.



Out of scope

13. Costs resulting from representative functions paid for by non-PCF income are excluded from this review.
14. The levy for the Legal Ombudsman and Office of Legal Complaints, will be noted in the project, but are out of scope in terms of a detailed breakdown of their costs as they have been examined [elsewhere](#).
15. While this strand may highlight areas where the LSB or one or more of the approved regulators are outliers compared to the benchmarks, any investigation into why this might be is out of scope of this project. However, if there is an obvious explanation, or one-off events distort the general picture this will be noted.
16. The Institute for Chartered Accountants in England and Wales (ICAEW) has recently become an approved regulator which can approve accountants for probate activities. However, as this organisation does not raise a practising certificate fee from providers and has only approved a very limited number of probate accountants the ICAEW are out of scope of this project. Likewise, while the [Institute of Chartered Accountants of Scotland \(ICAS\)](#) and [Association of Chartered Certified Accountants \(ACCA\)](#) are approved regulators for probate

activities they do not currently authorise anyone to offer this service. As Such they are out of scope of this project.

Benchmarking

17. The aim of this project is to assess and analyse the cost of regulators in the legal sector as a comparative study against a set of appropriate benchmarks.
18. The legal sector is regulated in terms of professional standards for competition purposes as part of the regulatory objectives set out in [section one of the Legal Services Act](#). Additionally the size of the legal services regulators and the number of reserved activities covered vary greatly. As such finding suitable benchmarks from other organisations which are of a similar size and have the same split of responsibilities will be challenging.
19. We plan to use external management accountants to help determine suitable benchmarks for the functions within each of the approved regulators and the LSB. Benchmarks are yet to be determined and could come from other regulated sectors, the public or private sector or from international experience.
20. From comparisons between the data gathered and these benchmarks, we will identify whether any of the regulators are outliers in any particular areas (for example, the cost of HR). We will compile as full a set of data about each of these bodies as is reasonably possible, or will determine reasons why the information cannot be found. This work will provide comments for each body outlining what the analysis has shown.
21. The intention is to create a set of benchmarks for the functions the approved regulators and the LSB carry out. The benchmarks are likely to fall within three broad categories:
 - 1) Generic functions of all organisations;
 - 2) Specific regulatory functions; and
 - 3) Specific functions relating to oversight of frontline regulators by the LSB.
22. In order to ensure appropriate comparators the results will be subject to sensitivity analysis to take account of e.g. the size of the authorised community and the number of reserved activities covered by a regulator. This is to correct for any distortions arising from the fact that certain tasks such as producing annual reports apply regardless of the size of an organisation. Therefore, if sensitivity analysis was not applied is it likely that certain functions would otherwise appear less efficient for smaller organisation.
23. Functions for benchmarking are still to be determined with the aid of management accountants but they are likely to include:
 - 1) Central functions such as HR, finance, governance; and

- 2) Regulatory functions such as authorisation, disciplinary processes and standard setting.
24. Generic functions (such as HR) are carried out in all organisations. For functions such as these benchmarks are likely to come from the wider economy.
25. Other functions (such as authorisation) are more specialised and benchmarks are likely to come from other regulated sectors. In terms of professional regulation there are a number of sectors which the legal services sector can potentially be compared to. Other [regulated professions in the UK](#) include health professionals, accountants and engineers. The sector(s) chosen for comparison will be determined on the advice of management accountants.
26. Additionally, as one of the regulatory objectives of the Legal Services Act 2007 is to promote competition, we will consider whether any activities relating to this are shared with the economic regulators in the UK.
27. As the LSB is an oversight regulator some of its functions are likely to be benchmarked against other similar organisations such as the Financial Reporting Council, the Professional Standards Authority or the Insolvency Service.
28. Work undertaken by the approved regulators has already costed a number of their functions. Any benchmarking categories already in use by the regulators will be considered when deciding on which benchmarks to use for this exercise.
29. Where possible the LSB will draw on data already publicly available through [practising certificate fee applications from the approved regulators](#) and annual accounts from all organisations within scope of this project. However, we expect that management accountants will request further unpublished financial data from the approved regulators and the LSB. This data will be used to establish and assess against the benchmarks but will not be published in its raw form.

As a result of this work stream we should know:

- 1) What are suitable benchmarks for functions carried out by the regulatory arms as well as any non-regulatory activities under permitted purposes carried out by the approved regulators?
- 2) What are suitable benchmarks for functions carried out by an oversight regulator?
- 3) Are the legal services regulators' cost of functions comparable with the benchmarks?

Future work

30. We envisage that further work may follow this project. We consider this stage of the work to broadly be about information gathering and developing a better understanding of the costs of the regulators themselves.
31. A potential next stage would look in more detail at the causes of any outliers identified in the benchmarking exercise. This would be with the ultimate aim of recommending where unnecessary regulatory burdens can be removed.
32. This project sits alongside other strands of work carried out by the LSB. The annual approval of the practising certificate fee and a project considering regulator spend against permitted purposes are among these. Any overlap and how to manage this will be borne in mind as the work progresses. Any recommendations arising from this strand of work longer term will be assessed against the regulatory objectives as set out in [section 1](#) of the Legal Services Act 2007. The objectives are:
 - protecting and promoting the public interest;
 - supporting the constitutional principle of the rule of law;
 - improving access to justice;
 - protecting and promoting the interests of consumers;
 - promoting competition;
 - encouraging an independent, strong, diverse and effective legal profession;
 - increasing public understanding of the citizen's legal rights and duties; and
 - promoting and maintaining adherence to the professional principles
33. They would also be assessed against the better regulation principles to ensure that any recommendations are suitable. The better regulation principles are that regulation should be:
 - 1) Proportionate;
 - 2) Accountable;
 - 3) Transparent;
 - 4) Consistent; and
 - 5) Targeted.