THE COST OF REGULATION

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Concerns about the cost of regulation are widespread amongst practitioners especially since the introduction of outcomes focussed regulation in 2011.

Having identified that there was no existing data on the cost of regulation, the Legal Services Board ("LSB") has recently commissioned an external research company to undertake a survey. Interestingly, the Financial Conduct Authority has conducted research into the cost of regulating financial services but, until now, there has been no similar study into the legal services market.

The LSB considered that it was important to establish the cost of regulation in the legal sector because the cost is borne by businesses and ultimately by consumers. It was said that *"only by establishing an evidence base about the cost of regulation can the LSB and the approved regulators review any areas of regulation that appear disproportionately costly relative to any benefits derived from those regulations"*

The LSB's study concentrated upon the *"incremental cost of regulation in the legal sector"*. Incremental costs were defined as costs that were incurred solely to comply with legal services regulation and that did not serve any other business or wider regulatory purpose. This definition was on the basis that if legal services regulations were removed for one type of regulatory cost included in the study then legal practices would save an amount of money equal to the incremental costs of that type of regulation.

If only it were that simple – what the LSB has failed to recognise is that some of the regulatory costs would have to be incurred for commercial reasons even if there were no mandatory regulation by the approved regulator.

Professional indemnity insurance is a prime example. The survey revealed (unsurprisingly) that the incremental cost for insurance *"was reported as nearly double that of the next highest incremental cost"*. However, it was recognised that insurance would be an essential cost for firms even if it were not a compulsory requirement.

Another area reported as high cost in terms of regulation was professional development. Again, firms could not opt out completely of training their fee earners and support staff. Negligence claims and higher professional indemnity insurance premiums would inevitably follow. The SRA has recently relaxed the rules but firms cannot avoid professional development even if it is not mandatory.

Ongoing supervision by the regulator was also acknowledged as a significant cost but here there was no commercial rationale or overlap identified for this cost. The introduction in 2011 of more onerous self-reporting duties has transferred cost to firms. Maintaining registers of non-material breaches just in case the SRA asks to see the list has added another task. COLPs and COFAs do not come without a cost. Much effort and cost has also been expended in assessing whether a breach is material and when and how it should be reported to the SRA.

Unexpectedly, the data revealed that firms were not too concerned about the cost of the separate requirements for client account. This is despite the fact that the SRA is about to embark upon a consultation to simplify the Accounts Rules.

The principal findings were that for entities on average the total cost of regulation as a proportion of total practice costs was between 15% and 23%. Whereas for individuals the cost associated with reserved activities was between 8% and 17%. The figures themselves are not that conclusive as the survey is only based upon a sample of 64 practitioners working across the legal services market.

The main criticism of this LSB research is the misconception that one can make a direct comparison between the cost spent upon a regulatory requirement and the cost saved if that requirement were abolished. Such an analysis is too simplistic. There may be a perfectly sound commercial reason for the obligation to continue. Although the data sample was small, it is an ongoing project so it can be expanded and refined. When the overarching regulator is concerned about the cost of regulation for those it regulates, it can only be described as a welcome development. ■

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