

<b>To:</b>	Legal Services Board	<b>Agenda Item:</b>	6
<b>Date of Meeting:</b>	19 July 2017	<b>Item:</b>	Paper (17) 47

<b>Title:</b>	<b>Independence of regulation</b>
<b>Workstream(s):</b>	Workstream: Performance, evaluation and oversight
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<b>Status:</b>	Official

**Summary:**

**Brief summary**

This paper shares initial thinking, including from stakeholders, on our review of the internal governance rules (IGR), and provides an opportunity to the Board to discuss this matter. The IGR, which the LSB is required to make, are intended to ensure the independence of regulatory functions from approved regulator representative functions, as far as reasonably practicable.

The paper also explains how the IGR review relates to the ongoing Law Society/Solicitors Regulation Authority investigation, given that the Board will be asked to consider the investigation further after the summer break.

**Recommendation(s):**

The Board's agreement is sought on the proposed two phased approach to this review (as discussed at paragraph 23) of:

1. publication of a 'green' paper on regulatory 'independence' principles later this year
2. subject to the outcome of that paper, consultation on revisions to the IGR.

**Risks and mitigations**

**Financial:** N/A

**Legal:**

[Redacted content]

	[REDACTED]
<b>Reputational:</b>	[REDACTED]
<b>Resource:</b>	[REDACTED]

Consultation	Yes	No	Who / why?
<b>Board Members:</b>		X	
<b>Consumer Panel:</b>		X	
<b>Others:</b>	All regulators and approved regulators, along with regulators in other relevant sectors, have been encouraged to engage on this work through informal initial one-to-one discussions with the LSB project team. Further formal and informal engagement is planned over the coming months.		

<b>Freedom of Information Act 2000 (Fol)</b>		
Para ref	Fol exemption and summary	Expires
Risks and mitigations: Legal	Section 42: information protected by legal professional privilege	Q3 2017/18
Risks and mitigations: Reputational and resource	Section 36(2)(b)(ii): information likely to inhibit the exchange of views for the purposes of deliberation	
Para 11, second half of fourth sentence; Para 17, second half of second sentence;	Section 36(2)(b)(ii): information likely to inhibit the exchange of views for the purposes of deliberation	
Footnote 10, first sentence and Annex A	Section 41: information was provided to the Board on the understanding that it would be kept confidential	

## LEGAL SERVICES BOARD

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### Independence of regulation

#### Purpose of this paper

1. Our business plan for 2017/18 includes a commitment to review our internal governance rules (IGR), which we are required to make by the Legal Services Act 2007 (the Act).<sup>1</sup> These are intended to ensure the independence of regulatory functions from approved regulator (AR) representative functions.
2. This paper is intended to provide context to our review, along with early thinking on our approach. We anticipate bringing more detailed proposals for the Board to consider in Q2.

#### Background

##### History of the IGR

3. By ascribing a role to and designating the historic professional bodies as ARs,<sup>2,3</sup> a tension is written into the Act in relation to regulatory independence. This occurs where ARs have delegated the performance of regulation to separate bodies, whilst remaining legally responsible for it. Barring exceptional circumstances,<sup>4</sup> the LSB is unable to remove that tension and primary legislation would be needed to change to the legislative framework.
4. The IGR are one of the key elements of the Act. They deliver the separation of regulation from representative interests, to counter perceptions of (and opportunities for) self regulation to operate in the interests of the legal professions rather than the interests of the public.
5. Section 30 of the Act provides that the LSB must make IGR to be met by ARs for the purposes of ensuring –
  - (a) that the exercise of their regulatory functions is not prejudiced by any representative functions they may also have; and
  - (b) that they must, so far as is reasonably practicable, ensure that decisions relating to the exercise of regulatory functions are taken independently from decisions relating to the exercise of any representative functions.

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<sup>1</sup> Section 30 of the Act.

<sup>2</sup> Section 20 of the Act.

<sup>3</sup> Schedule 4 to the Act.

<sup>4</sup> Section 45 of the Act provides for the cancellation of designation as an AR by order of the Lord Chancellor following a recommendation by the LSB.

6. It also specifies requirements that the IGR must place on each AR in relation to regulatory independence, eg ensuring the provision of resources reasonably required to exercise regulatory functions.
7. The IGR were first made by the LSB in 2009.<sup>5</sup> Since then we have partly amended them in 2014 in relation to lay chairs and board appointments and reappointments,<sup>6</sup> but otherwise they have not been reviewed in full.
8. When developing the IGR as our first major policy act, we hoped for ongoing constructive cooperation between ARs, their regulatory arms and the LSB. We took a principles based, rather than prescriptive, approach and were open to persuasion about the proportionate way to apply the IGR in the light of individual organisations' circumstances.
9. In addition to reflecting the terms of section 30 of the Act as general duties, the IGR place additional responsibilities on AR that carry out both regulatory and representative functions – with these described as Applicable Approved Regulators (AAR). This applies to the Association of Costs Lawyers (ACL), Bar Council, Chartered Institute of Legal Executives (CILEx), Chartered Institute of Patent Attorneys (CIPA), Chartered Institute of Trade Mark Attorneys (CITMA) and The Law Society (TLS). The LSB has concluded that the Institute of Chartered Accountants (ICAEW) does not currently fall within the definition of AAR. In contrast, the Council for Licensed Conveyancers (CLC) and Master of the Faculties (MoF) do not have representative functions and so are not in scope.
10. These AAR must comply with the schedule to the IGR, which sets out principles, rules and illustrative guidance. AAR arrangements must adhere to the four principles of governance, appointments, strategy and resources and oversight, with AARs then required to meet the rules in demonstrating compliance with the principles.
11. Since then the ARs have implemented arrangements for securing independence. We required self-certification on compliance with the IGR by the regulatory and representative arms of AARs in the years 2010-2013. Once we had reached the position of reported substantial compliance with the IGR, the LSB discontinued self-certification. Reasons included the resource intensive nature of this approach

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### **The rationale for this review**

12. The business plan commitment to review the IGR flows from a number of developments in the legal services market, including:

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<sup>5</sup> The IGR were set out in the LSB decision document of [December 2009](#), following consultations in [September 2009](#) and [March 2009](#).

<sup>6</sup> Amended IGR were set out in the LSB decision document of [April 2014](#), following a consultation in [February 2014](#).

- the government announcement in 2015 of its intention to consult on making legal services regulators independent from their representative bodies
- the LSB vision for legislative reform document, published in September 2016,<sup>7</sup> which explained why the LSB believes that the current lack of full independence between ARs and their frontline regulatory bodies is unlikely to be sustainable and noted the potential scope for representative bodies to delay reforms that would benefit competition and consumers
- the CMA legal services market study final report, published in December 2016, which identified a number of issues arising from the current regulatory structure. It considered that regulatory independence from providers and government is a fundamental principle for the regulatory framework and that the government should undertake a review of this as a priority<sup>8</sup>
- public commentary by regulatory and representative arms of some ARs on independence issues, plus their engagement with us, suggest issues with how the current IGR work in practice.

13. In the absence of a review by government of the legal framework, there is a need for the LSB to review the current IGR.

### **Practical experience of regulatory independence and the IGR**

14. In the early days following the initial introduction of the IGR, the role played by the LSB seems to have reflected the need for us to be more heavily involved while ARs were making extensive changes. Given the progress made, and in keeping with our regulatory approach,<sup>9</sup> we are not now typically involved to the same degree. However, reflecting the tension created by the regulatory framework (as discussed above), independence remains a bone of contention between a number of ARs and their regulatory arms, with issues continuing to be reported to us.

15. Over the last few years concerns discussed with the LSB have spanned all four of the IGR principles discussed above at paragraph 10. Some are highlighted by regulators as evidence of the need for legal separation. More recently, we have seen some disagreements playing out in the media rather than behind the scenes.

16. Practical consequences include AR, regulatory board and LSB management time and resources spent dealing with tensions around independence, rather than on other matters which could deliver improvements for consumers, the professions and the public. We understand from regulators that there may also be an anticipatory chilling effect on reform of regulation, where policies are diluted or

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<sup>7</sup>[http://www.legalservicesboard.org.uk/news\\_publications/LSB\\_News/PDF/2016/20160909LSB\\_Vision\\_For\\_Legislative\\_Reform.pdf](http://www.legalservicesboard.org.uk/news_publications/LSB_News/PDF/2016/20160909LSB_Vision_For_Legislative_Reform.pdf)

<sup>8</sup> In particular, paragraphs 5.145 to 5.154:

<https://assets.publishing.service.gov.uk/media/5887374d40f0b6593700001a/legal-services-market-study-final-report.pdf>

<sup>9</sup> [http://www.legalservicesboard.org.uk/what\\_we\\_do/pdf/Regulatory\\_Approach.pdf](http://www.legalservicesboard.org.uk/what_we_do/pdf/Regulatory_Approach.pdf)

not pursued by regulatory bodies in the knowledge that these will be contentious and/or that it will be disproportionately resource-intensive to deliver change.

17. An outline of views shared with us by the regulatory bodies is at Annex A.<sup>10</sup> Feedback on the current IGR is that the terminology is convoluted and open to interpretation [REDACTED]

[REDACTED]<sup>11</sup> There is desire for greater certainty or 'hard edges', including on what represents appropriate oversight by ARs, with differing views on what designation as an AR under the Act means they are required to do. In contrast to the regulatory bodies, there has been a push by some ARs to 'rebalance' regulation, through calls for some functions to revert to the professional bodies.<sup>12</sup>

### The IGR review

18. This review looks to understand the need for change to the IGR and associated guidance and consult on such changes. This involves communicating our understanding of the scope and limitations of the legal framework for IGR arrangements. We will examine the extent to which greater clarity can be delivered, for example, on:

- the boundaries of the AR role and assurance in relation to delegated regulatory functions
- regulatory board and chair appointments
- planning and resource allocation
- shared services
- practising fees, specifically in terms of AR arrangements for calculating and levying these in accordance with the current LSB rules<sup>13</sup>. Consideration of what constitutes permitted purposes under section 51 of the Act and can therefore be charged by ARs under the current LSB PCF rules is beyond the scope of this project, but this project may (amongst other things) indicate that this is something the LSB needs to look at (see paragraph 21)
- the definition in the IGR of AAR.

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<sup>10</sup> [REDACTED]  
[REDACTED] eg para 5.148: "In contrast to the SRA, submissions and meetings with other approved regulators and their frontline regulators, such as CILEx/CILEx Regulation, Bar Council/BSB and the ICAEW, have indicated general satisfaction with the current system of functional separation as supported by their specific internal governance arrangements."

<sup>11</sup> For example, the IGR use phrases like 'reasonable', 'so far as reasonably practicable', 'undue influence' (although the latter is defined in the IGR, that definition starts with 'pressure exercised otherwise than in due proportion to the surrounding circumstances...') etc. This approach reflects our position in the December 2009 Internal Governance and Practising Fee Rules, [Response to Consultation Document](#) (para 4.61): "The balancing act demanded by the Act's framework does not allow an approved regulator, regulatory arm, or the LSB to focus on the purely black and white. A reasonable path must always be trodden."

<sup>12</sup> For example, TLS and Bar Council responses to the Government's 2013 call for evidence on concerns with, and ideas for reducing, regulatory burdens and simplifying the legal services regulatory framework.

<sup>13</sup> Under section 51 of the Act.

19. In addition to exploring stakeholders' views, our work will reflect on learning from the previous IGR self-certification exercises discussed at paragraph 11 and our previous investigation of the Bar Council in 2013. We will take account any learning points from the current investigation. We will also consider developments in governance arrangements to secure independence in other relevant sectors.
20. It is clear the legislative framework will restrict the extent to which we can address some of the concerns we have heard. The requirements of the LSA cannot however be removed. While we may reduce their magnitude, we are unlikely to eradicate disagreements, given the inherent tension in the LSA described in paragraph 3. Well-functioning relationships between ARs and regulators will remain critical.
21. Equally, while we understand the desire amongst key stakeholders for the IGR to provide certainty and we believe incremental improvements can be made, our preferred approach remains outcomes focussed. Points relating to our practising fees rules (which were amended in June 2016) that are outside the scope of this review will be captured, to determine whether a further piece of work is needed.
22. Based on previous experience, the review is potentially a large, complex and contentious piece of work. Past experience suggests, for example, that consultations may identify additional issues needing to be addressed. As such, we will need initially to focus on specific policy areas that are a priority, such as the boundaries of the AR role when it has delegated its regulatory functions.
23. At this stage, we are considering a two phased approach. This reflects support among some stakeholders for publishing a 'green' paper on regulatory 'independence' principles later this year. This may explore the legal framework, issues and suggestions raised by stakeholders, principles that might apply in revising the IGR and potential mechanisms for assuring compliance with them, without offering a specific redraft of the IGR at that stage. This would inform any subsequent stakeholder engagement and consultation on revisions to IGR drafting.
24. Ultimately, the success of any changes deemed necessary to the IGR in order to secure regulatory independence is likely to be in providing additional clarity, thereby reducing the incidence of the types of issues discussed at paragraph 17. Measurement of success would include monitoring the number of issues flagged with and identified by us.

### **Next steps**

25. Subject to the Board's views, we will continue to engage with stakeholders, with a view to bringing the LSB green paper discussed above to the Board in advance of publication in Q2.