

To:	Board	
Date of Meeting:	13 July 2011	Item: Paper (11) 54

Title:	Internal Governance Rules (IGR) – July 2011	
Workstream(s):	Securing independent regulation	
Introduced by:	Crispin Passmore, Strategy Director crispin.passmore@legalservicesboard.org.uk/ 020 7271 0086	
Author:	James Meyrick, Regulatory Project Manager James.meyrick@legalservicesboard.org.uk/ 020 7271 0083	
Status:	Protect	

Summary:

This year's IGR exercise shifted the focus of the work from reviewing the newly established governance arrangements to insisting on practical and effective measures to embed those arrangements in systems and the conduct of personnel. To do so, we required Applicable Approved Regulators (**AAR**) to complete a risk assessment and answer a series of AAR-specific questions. This paper considers the submissions received from The Bar Council and Bar Standards Board (**BSB**).

The Bar Council and BSB have made a number of improvements to their arrangements this year and they are making good progress in relation to achieving a lay majority. They still need to remove the rule that specifies the profession of the Chairman with reference to the profession of the Vice-Chairman, and there remain governance risks to regulatory independence. These arise from the public perception of a lack of independence and from the dominance of the profession on committees.

However, the major concern identified by the LSB in relation to the BSB's independence is the overarching role that the Finance and Audit Committee (**FAC**) plays in relation to the provision of funding to the BSB. We believe that The Bar Council has not designed these arrangements with malign intentions, but their effect is to fetter the independence of the BSB. We have expressed these concerns to The Bar Council and BSB in writing and directly to Nick Green QC (who is reviewing some of the current arrangements).

We have suggested that, to the extent that decisions on the Green Report do not lead to a plan to put the necessary separation in place within an acceptable timetable (we suggest the end of the year to match the BSB's plans to build up its own programme management infrastructure), the Board will take action to monitor closely the work of the FAC to ensure that it is not detrimental to regulatory independence.

Risks and mitigations	
Financial:	N/A.
FoIA:	Initial assessment: s22, s36(2) and s44.
Legal:	The Bar Council / BSB may resist any request for information about the FAC. We might, therefore, have to use our powers to require its provision.
Reputational:	High profile area which is one of three key LSB business priorities.
Resource:	N/A.

Consultation	Yes	No	Who / why?
Board Members:		✓	Not possible due to tight timeframes.
Consumer Panel:		✓	
Others:	No.		

Recommendations:
<p>The Board is invited:</p> <ol style="list-style-type: none"> 1) to agree The Bar Council and BSB's joint certificate response, with the proviso that: <ol style="list-style-type: none"> a) the BSB sets out the timetable to abandon the rule requiring the Chairman or the Vice-Chairman to be a barrister b) if a satisfactory action plan to reform the FAC is not put in place, The Bar Council provides the last six months of BSB related papers and full minutes from the FAC; and to provide papers 72 hours in advance of meetings of the Committee for as long as the current level of potential control exists 2) to agree that the LSB, in its response, will note the importance of ensuring both the practice and the perception of regulatory independence and provide The Bar Council and BSB with the advice provided to CIPA, ITMA and IPReg last year in relation to the setting of regulatory budgets 3) to delegate the final decision in relation to paragraph 1 (b) to the Chairman, the Chief Executive [and one Lay and one Non-Lay Board Member], as The Bar Council's response will probably not be known by the time of the meeting.

LEGAL SERVICES BOARD

To:	Board		
Date of Meeting:	13 July 2011	Item:	Paper (11) 54

Internal Governance Rules – July 2011

Recommendation

The Board is invited:

- 1) to agree to approve The Bar Council and BSB's joint certificate response, with the proviso that:
 - a) the BSB sets out the timetable to abandon the rule requiring the Chairman or the Vice-Chairman to be a barrister
 - b) if a satisfactory action plan to reform the FAC is not put in place, The Bar Council provides the last six months of BSB related papers and full minutes from the FAC; and to provide papers 72 hours in advance of meetings of the Committee for as long as the current level of potential control exists
- 2) to agree that the LSB, in its response, will note the importance of ensuring both the practice and perception of regulatory independence and provide The Bar Council and BSB with the advice provided to CIPA, ITMA and IPReg last year in relation to the setting of regulatory budgets
- 3) to delegate the final decision in relation to paragraph 1 (b) to the Chairman, the Chief Executive [and one Lay and one Non-Lay Board Member], as The Bar Council's response will probably not be known by the time of the meeting.

This year's exercise

1. Our Business Plan made it clear that we would conduct an IGR exercise during 2011. However, we said that we would shift the focus of the work away from reviewing the newly established governance arrangements, and instead review the practical measures taken by AARs to embed independence in systems and the conduct of personnel. To investigate these areas, we designed a risk matrix, in addition to the regulatory independence certificate, to provide an open and transparent framework for assessing and monitoring compliance.


Update on progress

2. At the last meeting, the Board agreed to certify ILEX and ILEX Professional Standards (IPS) and CIPA, ITMA and IPReg's dually completed regulatory independence certificates as compliant with the IGRs. At the same time, the Board also reviewed the CLSB's progress on its action plan for delivering compliance with the IGRs and the start up of its regulatory function. This was also accepted.
3. As noted at the last meeting, The Law Society and SRA draft responses identified a number of issues that will require an extended period of contemplation before they will be able to agree a final response. The Chief Executive has been working with his opposite numbers on the work they have put in hand and are starting to discuss with their office holders and senior colleagues. An update will be provided at the meeting.
4. We agreed an extension to the deadline for The Bar Council and BSB submission, which is considered in this paper.


The Bar Council / BSB submission

5. The Bar Council and BSB opted to submit a joint draft certificate and risk assessment – contrary to our original request. However, we were happy to review the submissions. We then met representatives of The Bar Council and the BSB to discuss regulatory independence and the LSB Executive's initial assessment of the submissions.
6. Following this meeting, the LSB Executive has arrived at a number of conclusions in each of the different risk areas. These are summarised below in order of priority.

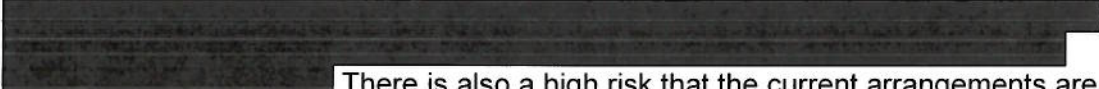
Setting and managing strategy and resources

7. These two risks have been considered together as the matters of concern are linked to the same issue.
8. Overall, we believe that the process for determining the BSB's business plan appears independent, although some concern could be levelled at the amount of input from officers of The Bar Council. However, the most pressing concern surrounds the provision of finance to the BSB to carry out the agreed business plan and the BSB's budgetary process.
9. The provision of finance to the BSB is governed by the recently produced finance manual and the FAC. The FAC consists of representatives from The Bar Council, BSB and additional lay members. This membership perhaps reflects a desire of The Bar Council to comply with the requirement of regulatory independence. However, in practice, the membership will, as currently constituted, always have a majority of professional members (seven out of 13) and has greater representation from The Bar Council than the BSB (five from The Bar Council – including The Bar Council Chief Executive – and four from the BSB).
10. The membership of the FAC is important when considered against the extensive role it appears to conduct. Its remit includes reviewing and proposing changes to the level of the practicing fee, it has a role in the staff appraisal process, it determines the annual pay award and sets the remuneration strategy for staff. However, more concerning is the role it plays in setting the budget for the BSB. The text of the finance manual suggests that, not only must budget bids be accompanied by a business case for the FAC to consider, but if the proposed BSB budget is disputed it will be subject to an item by item review (in which The Bar Council representatives will take a strong role). Pleasingly, the criteria for any review include the need to have regard to regulatory independence, the need to provide necessary resources to the BSB and to have regard to the BSB's objectives. But there is also a criterion to consider the financial burden on the profession. A similar outlook and approach to the setting of IPReg's budget was considered inappropriate by the LSB during last year's IGR process and we provided advice to CIPA and ITMA not to take this approach.
11. Once the BSB budget has been agreed, any virement from that budget of above £5,000 must be considered by the FAC. Any such requests must be accompanied with detailed information on why the proposer wishes to use funds originally allocated to one activity for a different activity – effectively, a business case must be produced and approved.

12. The BSB does not have the freedom to access funds above £1,000 – even if they are in relation to items agreed as part of the budget. For sums of between £1,000 and £25,000,

the signature of the Chief Executive and Chief Accountant is required; for amounts above that, a Bar Council officer's signature is required.

13. The LSB appreciates that The Bar Council has attempted to balance the needs of financial discipline with the requirements of the Legal Services Act 2007 (**the Act**) and has acted in good faith. The Council asserts that the Chief Executive, Head of Common Services and Chief Accountant are acting in proper corporate and AR roles in making such decisions, rather than as agents of the representative arm. However, this does not address the perceptual point.
14. Moreover, the current arrangements go beyond that of a traditional audit function and appropriate oversight of the regulatory board. It is the LSB's belief that the starting point of the arrangements should be that BSB should be provided with the totality of the budget for the totality of the regulatory task: more detailed approval should be needed only in relation to exceptional spend for a specific defined reason. Budget disputes should be resolved in line with our advice to CIPA, ITMA and IPReg last year. This advice was that disputes should be resolved with explicit reference to the regulatory objectives and an assessment of the regulatory priorities of the regulator and not through an item by item review of the proposed budget.
15. The regulatory board should clearly be accountable to The Bar Council for ensuring that appropriate processes and scrutiny occurs for all BSB expenditure. However, the BSB should not have to seek approval for spending or changing spending priorities due to emerging regulatory issues. We believe that the current arrangements could fetter the regulatory arm from conducting work that it deems necessary – as much because of the unconscious cultural effect as because of the formal restrictions in the governance arrangements.
16. A review by Nick Green QC is looking at the role of the Chief Executive of The Bar Council and the governance of The Bar Council. We have expressed our disquiet about the current BSB financial and budgetary arrangements to Mr Green. We understand that one of his recommendations will be to reform the FAC into separate audit and finance committees and to create separate finance functions for The Bar Council and the BSB.

17. We believe that we need to repeat the concerns that the Chairman and the Chief Executive have already expressed to Nick Green directly to The Bar Council. We have therefore written to the BSB and The Bar Council indicating that we believe that it would be significantly more in keeping with the IGRs:
 - for there to be a clear separation of the two functions of the FAC
 - for the role of the Finance Committee to be restricted only to agreement of the initial allocation to the BSB, in-year adjustments to that allocation and only the most significant virements (we have suggested over £200k in relation to total free spend (i.e. non staff and non shared services) of £800k)
 - for the Audit Committee's role in relation to the BSB to be to provide assurance to The Bar Council as the AR about the strength of systems and propriety of expenditure.
18. We have suggested that, to the extent that decisions on the Green Report do not lead to a plan to put such separation in place within an acceptable timetable (we suggest the end of the year to match the BSB's plans to build up its own programme management infrastructure), the Board will take action to monitor the work of the FAC closely to ensure that it is not detrimental to regulatory independence.

19. In this latter case, we propose requesting The Bar Council to provide the LSB with all FAC papers that relate to the provision of funding to the BSB and the full FAC minutes for the last six months. We wish also to request the provision of such papers 72 hours in advance of each meeting of the FAC for as long as the level of potential control exists. This is in line with the principle set out at the outset of this work: that the more complex the arrangement, and the more it appears to offer an opportunity for the representative board to influence or control the regulatory arm, then the closer oversight we will take.
20. The review of such papers would allow us to assess the FAC against the specific risks identified in the original risk assessment matrix. The pertinent risks are that the: 'regulatory arm is unable to develop and set new strategies in response to market developments without representative body approval'; 'regulatory arm unable to assign resources to new issues without representative arm approval'; 'regulatory arm unable to access money directly'; and 'regulatory arm subject to disproportionate scrutiny from representative arm [in relation to accessing and managing resources]'. In addition, such scrutiny may act as an incentive for The Bar Council and BSB to reform their arrangements.

21.  There is also a high risk that the current arrangements are contrary to Part 3 A (strategy and resources, etc) of the schedule to Internal Governance Rules 2009.

Governance

22. In line with the agreement reached with The Bar Council / BSB during last year's IGR exercise, the BSB intends to have a lay majority by 2012. It is currently in the process of recruiting four new lay members. These will be selected in July and will take up their posts on 1 January 2012, achieving a lay majority.
23. BSB has yet to make the changes to the constitution regarding the requirement that either the Chairman or the Vice-Chairman has to be a barrister. At our meeting, we noted that this is contrary to the IGR schedule with which they must comply; we suggested that it may be possible to amend the rule so that it only refers to the Vice-Chairman, but does not fetter the choice of Chairman. They are disinclined to do this, therefore, we will press them to abandon the rule.
24. Their response noted that the governance handbook would not be produced until March 2012 and the new standing orders by July 2011. We expressed concern at the length of time it appeared to be taking to produce the governance handbook. The BSB reassured us that the date was a 'latest possible' and that they hoped for approval of the handbook much sooner than March 2012. Additionally, they confirmed that the contents of the governance handbook referred almost entirely to the operation of the BSB and its committees, and not its relationship with The Bar Council.
25. The committees that sit below the BSB all have lay membership and in the case of the professional conduct committee the lay members can veto all decisions relating to the dismissal of complaints. The other committees tend only to make recommendations to the BSB, rather than take decisions. The LSB Executive welcomes the steps that have been taken on committees. However, there remain risks to the practice and perception of independence of these committees and so the BSB as a whole – especially given the relatively higher importance of the committee structure to the BSB than to other ARs.
26. We sought also more information about the role of the Chairman's Committee. This committee currently appears to be acting more as an information exchange and as one of the final ports of call to resolve disputes that arise between The Bar Council and BSB. The LSB is content with this explanation, although we noted that the terms of reference

for this committee were broad (as it encompasses all aspects of the relationship between the two organisations) and its work should not stray into an attempt to control the BSB.

27. The LSB has also noted that media commentators and others have expressed a level of cynicism about the independence of the BSB from the profession. The forthcoming arrangements for the period in which there will be no Chief Executive of The Bar Council may well exacerbate this perception. The Bar Council and BSB have been disappointed with such media commentary and feel that it misrepresents the relationship between the two organisations. The LSB recognises that it could be a misrepresentation, but noted that the perception of regulatory independence is an important aspect to public confidence in the regulatory regime.
28. The BSB and The Bar Council have made good progress to achieving compliance with the IGR schedule – in line with the agreements reached last year.

[REDACTED]

Shared Services

29. Service level agreements (**SLA**) have been produced and agreed by The Bar Council and BSB and were provided to the LSB for inspection.
30. The SLAs have not been in place for a full year; however, their contents and the review mechanisms put in place seem appropriate. The only area of potential concern is what will occur in the event of a resource squeeze between the demands of The Bar Council and those of the BSB? This is most obvious in relation to the provision of research services to the BSB from The Bar Council. Access to research that helps to address and understand emerging regulatory priorities is an important part of efficient regulation and it is unclear what would happen if such resources were unavailable to the BSB. As these mechanisms, and indeed the research function, are so new, there has been no experience of such a resource squeeze on which the LSB can base an assessment. This is something that the LSB should return to in future independence exercises.

Application processes

31. We have no concerns about the arrangements for applications from the BSB, although this will be kept under review as a number of major rule change applications are due to be considered by the LSB in the next few months.

Conclusion

32. The Bar Council and BSB have made a number of improvements to the arrangements this year and they are making good progress in relation to achieving a lay majority. They still need to remove the rule that specifies the profession of the Chairman with reference to the profession of the Vice-Chairman, and there remain governance risks to regulatory independence. These risks arise from the public perception of a lack of independence and from the dominance of the profession on committees.

[REDACTED]

33. The major concern in relation to the BSB's independence is the overarching role that the FAC plays in relation to the provision of funding to the BSB. We believe that The Bar

Council has not designed these arrangements with malign intentions, but their effect is to fetter the independence of the BSB. The LSB should make it clear to The Bar Council that the BSB needs to be provided the totality of the budget for the totality of the regulatory task. As a risk-based response to the concerns about the activities of the FAC, the LSB should request all relevant papers for the last, and the next, six months.

List of Annexes:

Annex A: The Bar Council and BSB dual self-certification of regulatory independence

Annex B: The Bar Council and BSB draft risk assessment response.

04.07.11