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| <b>To:</b>              | Legal Services Board |                            |
| <b>Date of Meeting:</b> | 11 September 2013    | <b>Item:</b> Paper (13) 59 |

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|--------------------------------|---|--|
| <b>Title:</b>                  | Chairs of Regulatory Bodies   |  |
| <b>Workstream(s):</b>          |   |  |
| <b>Author / Introduced by:</b> | Crispin Passmore, Strategy Director<br>Crispin.passmore@legalservicesboard.org.uk / 020 7271 0086 |  |
| <b>Status:</b>                 | Unclassified  |  |

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| <b>Summary:</b>  |
| This paper sets out a proposal to consult on amendment to the Internal Governance Rules so as to require that the Chair of the Board (or equivalent) of each approved regulator be a lay member. |

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| <b>Recommendation(s):</b>   |
| The Board is invited to: <ol style="list-style-type: none"> <li>1. Agree to consult for six weeks on a proposal that the Internal Governance Rules (IGR) made under s30 Legal Services Act 2007 (the Act) are amended so as to require that chairs of regulatory boards are lay.</li> <li>2. Delegate sign off of a short consultation document, based on this paper to the Chair and Chief Executive.</li> </ol> |

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| <b>Risks and mitigations</b>  |
| <b>Financial:</b>   |
| <b>Legal:</b> This issue should not be conflated with the ongoing investigation into the Bar Council. This paper looks at increasing likelihood of regulation that is independent of professional interest beyond that of the representative function of the professional body and recognises the advantages of encouraging independence, as opposed to using enforcement tools after the event.  |
| <b>Reputational:</b> The Board, in accepting these recommendations, may be accused of changing its mind on the issue of lay chairs. The decision in 2009 was a complex one made as part of a package. The revised approach now being considered is based upon experience in practice, but will always be a judgement for the Board given the impossibility of demonstrating cause and effect relationships. The consumer panel and other consumer groups are likely to welcome the board's belated conversion to their 2009 position. |

**Resource:** This work is not in the current business plan. It was part of early drafts of the year's work programme but was removed because of prioritisation and resource pressures. However, the executive considers that this can be managed within current resources by limiting focus narrowly to the issue of lay chairs and careful reprioritisation.

| <b>Consultation</b>    | <b>Yes</b> | <b>No</b> | <b>Who / why?</b>   |
|------------------------|------------|-----------|---|
| <b>Board Members:</b>  |            | <b>X</b>  | Paper produced in response to Board request to do so when considering IGR self certification. |
| <b>Consumer Panel:</b> | <b>X</b>   |           |   |
| <b>Others:</b>         |            |           |   |

| <b>Freedom of Information Act 2000 (Fol)</b> |                                  |                |
|--|----------------------------------|----------------|
| <b>Para ref</b>                              | <b>Fol exemption and summary</b> | <b>Expires</b> |
| N/A  | N/A                              | N/A            |

## LEGAL SERVICES BOARD

|                         |                      |                            |
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### Lay Chairs of Regulatory Bodies

#### Background

1. In agreeing the outcome of the Internal Governance Rules (IGRs) dual self-certification process in its meeting on 11 July, the Board noted continuing concerns about the level of potential “cultural”, rather than “structural” capture of regulators and asked the Executive to consider the scope of a consultation exercise on the specific issue of whether lay chairs of regulatory arms should be mandatory.
2. The current legal background is set out in the annexes. Annex A sets out general duties to ensure regulatory independence enshrined in the [Internal Governance Rules](#)<sup>1</sup>. Annex B shows the relevant section of the rules dealing with the appointment of regulatory boards, with the changes needed to secure lay chairs in ~~strikeout~~ and highlighted text.
3. In the Act and the IGRs the definition of “lay” is this:

“In this Schedule a reference to a “lay person” is a reference to a person who has never been—

  - (a) an authorised person in relation to an activity which is a reserved legal activity;
  - (b) a person authorised, by a person designated under section 5(1) of the Compensation Act 2006, to provide services which are regulated claims management services (within the meaning of that Act);
  - (c) an advocate in Scotland;
  - (d) a solicitor in Scotland;
  - (e) a member of the Bar of Northern Ireland;”<sup>2</sup>
4. This statutory definition applies to the Chair of the LSB and certain other positions such as the Chief Ombudsman of the Legal Ombudsman and chair of the OLC.
5. One effect of including the Act’s definition in the IGRs was to change the status of Baroness Deech as chair of the BSB. She had previously been regarded by the Bar as lay, because she had never practised as a barrister or undertaken pupillage, but the Act’s definition (incorporated into the Board’s IGR) means that she is now non-

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<sup>1</sup> [http://www.legalservicesboard.org.uk/Projects/pdf/internal\\_governance\\_rules%202009\\_final\\_km.pdf](http://www.legalservicesboard.org.uk/Projects/pdf/internal_governance_rules%202009_final_km.pdf)

<sup>2</sup> Legal Services Act 2007, Schedule 1, paragraph 2(4)

lay, as she has been called to the Bar and was thus entitled to administer oaths as an authorised person (prior to the BSB removing this entitlement more recently).

### **The Board's Previous Analysis**

6. In finalising the IGRs in 2009 the Board (in Board Paper 09(46)) considered alternative policy options:

- require either a majority of lay persons or a lay chair (or both) in an attempt to bolster public confidence in the independence of the framework; or
- require a membership where no fewer than half the board members are lay and ensure that there are no limitations on lay persons becoming chairs.

The Board decided that it would insist upon lay majorities but rejected the option of insisting on lay chairs, despite the support of consumer bodies and the chair of the LSB consumer panel.

7. The analysis was broadly about perception and balance within the entire package, at a time when the Board faced accusations of “consumer zealotry” and also of the cost of forcing new recruitment of new chairs on existing bodies. There was rather less consideration of the need for consistent application of the principles for membership of the LSB and OLC as set out in the Act being read through into the approved regulators.

8. The Board's analysis in 2009 focused predominantly on two areas. Firstly the structures of approved regulators and secondly the securing of independence of regulation from representative influence. Our experience since then has led the executive to recognise the importance of independence from the profession or regulated community as well as from the representative or professional body.

### **Current issue and analysis**

9. The issue seems to the Executive to be “live” now for a number of reasons:

- The increasing recognition by the Board that independence from the profession is as important as independence from the professional or representative body. This is a point well made in the Board's submission to the minister's call for evidence.
- The clearly diminishing utility of the IGR self-certification exercise, as a check on undue “soft” influence on regulators;

- The fact of new BSB and SRA chair appointments being due in the course of 2014, so that any decision to change would need to be made relatively quickly if it is to secure impact in the medium-term in the most high-profile regulators;
- The need to be consistent in our practice in this area with the arguments we have put forward in relation to independence and structural separation in our submission to the Lord Chancellor's call for evidence (and, conversely, the diminishing case for inconsistency with the approach taken in the Act, given the commonality of objectives between LSB and the front-line regulators);
- The concerns emerging through the regulatory effectiveness process about the inconsistent quality of Board processes and scrutiny in the front-line regulators.

## **The Performance Context**

10. The Board has been concerned that the regulators are not consistently committed to the liberalisation of their regulatory approaches. While the key regulators have taken significant steps forward in terms of allowing ABS, shifting their models towards outcomes and refocusing on risk based supervision, progress is still held back by traditions of barriers to entry and cultural ties to each regulator's 'bit' or title within the legal profession. This manifests in a number of ways in both policy substance and governance arrangements:

- SRA reluctance to remove separate business rule
- SRA approach to in house solicitors
- SRA approach to multi-disciplinary practices
- SRA pace of ABS authorisation and over emphasis on looking like they are controlling entry (when in actual fact less than five ABS licences have been refused)
- SRA and others' resistance to single appeals mechanism
- BSB reluctance to embrace non-barristers leading entities
- BSB refusal to enforce against outcomes
- Regulators' scepticism about data transparency in general and failure to make the data they have in a range of areas widely available to enable independent analysis (so called 'big data' analysis)
- Regulators' handbooks remaining complicated and prescriptive
- Tendency to offer very detailed guidance in relation to changes which can be taken as mandatory
- Tendency to evolve complex sub-committee structures to scrutinise the micro-, rather than macro- impact of proposed changes.

11. Some of this arises from the Act passporting regulators' previous (i.e. pre-coming into force of the Act) regulatory arrangements into the new statutory framework. As set out in the MoJ submission, the result is that modernising and liberalising existing regulatory arrangements is predominantly within the purview of front-line regulators, as the LSB only has limited tools to enforce such review and action. The Executive assesses that this reticence to embrace the better regulation principles can put the regulatory objectives at risk. In particular, the continuing tendency to produce complex handbooks and detailed rules continue to threaten innovation and undermine competition, thus limiting consumer choice and compromising access to justice.
12. The Board may also wish to note the level of commentary about the LSB's relentless focus on consumer interests. This has been described as a "*cult of consumerism*" and that an "*excessive focus on the consumer interest may be to the detriment of the professional interests and standards upheld by the lawyers*".

### **The Case for Change**

13. The question is whether further changes to Board composition would help build greater proactivity in this area on the part of regulators themselves. Overly strong ties to the history, culture and practice of self regulation by each part of the regulatory community are a significant drag on regulators complying with the better regulation principles and thus may put the regulatory objectives at risk. It therefore seems probable that the tendency of the regulators to hold on to a 'what they know' preference would be diminished by insisting on "a fresh pair of eyes" at chair level, provided that the boards as a whole have the right balance of skills and knowledge around the table.
14. The Executive is not arguing that the IGRs as a whole are 'broke', 'failing' or 'in need of replacement'. Rather it is the Executive's position that a range of additional steps can be taken to give regulators the best opportunity to be as independent and effective as they can. Some of these are about requiring compliance with broad principles of independence (as the IGR do at present). Some others are about the make-up and appointment of regulatory boards and have already been put in place:
  - Requiring a lay majority
  - Ensuring 'Nolan type' appointment processes
  - Preventing the requirement of a lawyer chair

By amending the final of these three to require a lay chair, the expectation is that the tide in favour of independent regulation will get another boost. It is, of course, not a silver bullet – it would still possible to appoint a chair that does not have the requisite skill, experience and independence even if they were lay, and there are bound to be lawyer candidates that have the potential to be able to deliver what the

LSB expects. The argument is that the likelihood of securing a Chair that delivers independence from the profession is increased if lawyers appointed by the professional body are excluded. At the end of the day, this is a matter for judgement, rather than being susceptible to numeric analysis.

15. Our current IGRs rightly therefore stress the importance of each Board having the right skill set. The rules refer to the section of the Act that advises the Lord Chancellor on the background of LSB Board members. In practice, there has been a danger of front-line regulators confusing breadth of background – i.e. having a lawyer from each part of the market (large firm, small firm, in house, legal aid etc) on the Board in a quasi-representative manner - with breadth of skills and knowledge – e.g. in relation to leadership, regulatory expertise, governance and Executive challenge. It seems more probable that better balanced boards would emerge in a world where more of the chairs had leadership experience in a corporate governance context in other organisations (and ideally other sectors) where the need to address these questions of Board composition, balance and performance are more likely to have been tested than in a purely legal background.
16. Dianne Hayter responded in a personal capacity to the 2009 IGRs consultation because the Panel hadn't been fully formed. On lay chairs, she wrote: *'The arguments for requiring a lay chair are perhaps more finely balanced. If, in five years time, it turns out that every chair is a lawyer, it will be difficult for the approved regulators to maintain that appointments were made strictly on merit.'*<sup>3</sup>
17. The Panel has reiterated this view in its Consumer Impact Report while noting that the proportion of lay chairs is unchanged. Our expectation, though we do not know at this stage, is that the Panel would be supportive of the proposal. This would likely be based on arguments around public confidence and evidence of a lack of cultural independence.
18. The Board should note that even if it decides to proceed with a consultation to amend its rules as proposed, this does not obviate the requirement to consider enforcement action, either against breaches of the previous rules or in cases when breaches occur in future. While securing compliance before the event is of course preferable (and this change is designed to assist with that), investigation of and subsequent enforcement action any possible breach of the revised IGR remains a possibility. Constant vigilance must remain alongside clear expectations on outcomes, supporting rules where necessary and clear guidance.

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<sup>3</sup> [http://www.legalservicesconsumerpanel.org.uk/publications/consultation\\_responses/documents/2009-10-30\\_LSB\\_ConsultationInternalGovernanceRules.pdf](http://www.legalservicesconsumerpanel.org.uk/publications/consultation_responses/documents/2009-10-30_LSB_ConsultationInternalGovernanceRules.pdf)

## Options

19. If the Board agree that policy should develop in this direction, there are a number of options:

- the Board could decide not to make changes to the IGR at this stage but to increase its focus on compliance with the overarching principles in the IGR, investigating potential breaches and taking enforcement action where appropriate. The thresholds for this remain relatively high and resource intensive but the potential for this must remain on the table regardless of the change to a requirement for lay chairs. This option is likely to be high impact where used but also resource intensive both in monitoring and delivery of any investigation.
- seeking a supervisory role in Board appointments. In the health regulatory sphere, the Professional Standards Authority has a remit somewhat akin to the Commissioner for Public Appointments in scrutinising appointment processes and job and person specifications for Board roles (but with no authority to challenge the individuals appointed). If the Board were attracted to this, we could research the legal background and resource consequences further, but our initial view is that this would be intrusive and do little more than duplicate the OCPA like processes which many of the regulators already have in place;
- the LSB could prescribe a generic competency framework for the position of Chair or whole regulatory boards. This could set out the range of skills, knowledge and experience that each board needs to demonstrate collectively and in the chair. This could be enshrined in S162 guidance, which has the effect of causing regulators to “comply or explain”. The executive’s view is work on board balance, rather than immediate leadership, might be best approached through regulatory standards work or targeted/thematic activity so as to garner ownership of skills, performance and development at existing boards;
- consult on making a simple rule change on the lines of Annex B – this would have a greater immediate impact and be significantly less resource intensive for all parties. In developing arguments for consultation, we would need to set these points against the fact that it would be seen as inconsistent with earlier decisions and arguably more intrusive (if less time-consuming) than the alternatives. This option is likely to have most significant impact over the medium term.

20. Not least given the immediate timing issues of forthcoming appointments, the Executive consider that the balance of advantage lies with the final option. The



executive considers the penultimate option and the initial option also have some merit but might better supplement the final option, rather than be alternatives to it.

21. The do nothing option may also be linked to the current Ministerial call for evidence. The Board's submission, as already noted, makes some play of the role of independence in underpinning better regulation. The Board could wait for the outcome of the Minister's contemplation of responses and, if the Minister committed to early action on shifting away from the current model of self regulation linked to internal governance rules and LSB oversight, it could park the issue, or, in the alternative scenario of Ministerial inaction, devote more resource to this in the next business plan. While this has some attraction in terms of planning, the window for influencing the next round of appointment at the two most significant regulators is short. Consultation would need to be well underway before Christmas if any ultimate rule change was to be in place to influence the selection decision.
22. If the Board agree to consulting on changes to the IGR, there is an important point of detail to resolve. The change in Annex B implies a rule across all regulators. As an alternative, it would be possible to argue that the change ought to be limited to SRA, BSB and CLC, as the organisations whose regulated community engage more directly (and on scale) with the general public and hence present the potential for the greatest risk to the regulatory objectives.
23. Should the Board consider that the emphasis should be on consistency, then the aim might be to make a rule change take early effect but to let existing legally qualified chairs serve out their term of office.<sup>4</sup> Michael Heap of IPREG, whose term expires in 2015, is the only other affected Board chair. Rather than a rules based transitional protection, it is likely that this can be addressed through a proportionate approach to compliance activity - i.e. agreeing a timeframe with IPREG (or indeed, potentially any other regulator) for the appointment of a new Chair that meets any new requirements. However, the board will want to avoid a rush of appointments of new professional chairs by regulators (ahead of a rule change) that are then in place for several further years and will need to consider this issue carefully as it moves forward through consultation.
24. There may need to be some form of more permanent "carve out" for Charles George QC, the Master of Faculties, who is the only individual to be designated as a statutory regulator and whose other ecclesiastical law functions demand that he be legally qualified.

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<sup>4</sup> Currently, professional Chairs are in post at SRA, BSB and IPREG

## Timing

25. Given the tight focus of the consultation and the fact that the issue has been debated extensively in recent years, we recommend that the Board should adopt a consultation period of six weeks for this proposal. The consultation will run through a period without traditional holiday dips (such as summer, Christmas and Easter) that often justify longer consultations. The Board will note that the cabinet office guidance on consultations (and our own approach follows this) no longer specifies 12 week consultations as the norm.

26. During the consultation period the executive will offer to meet with each approved regulator, professional body and regulator, as well as encourage engagement and responses from consumer groups.

## Recommendation

27. The Board is asked to:

- Agree to consult for six weeks on a proposal that the IGR made under s30 of the Act are amended so as to require that chairs of regulatory boards are lay
- Give a steer on whether the amended rule be applied across all regulators or on a risk-based basis.
- Delegate sign off of a short consultation paper to the Chair and Chief Executive.

## **ANNEX A**

### **C. GENERAL DUTY TO HAVE IN PLACE ARRANGEMENTS**

6. Each Approved Regulator must:

(a) have in place arrangements that observe and respect the principle of regulatory independence; and

(b) at all times act in a way which is compatible with the principle of regulatory independence and which it considers most appropriate for the purpose of meeting that principle.

7. Without limiting the generality or scope of Rule 6, the arrangements in place under that Rule must in particular ensure that:

(a) persons involved in the exercise of an Approved Regulator's regulatory functions are, in that capacity, able to make representations to, be consulted by and enter into communications with any person(s) including but not limited to the Board, the Consumer Panel, the OLC and other Approved Regulators;

(b) the exercise of regulatory functions is not prejudiced by any representative functions or interests;

(c) the exercise of regulatory functions is, so far as reasonably practicable, independent of any representative functions;

(d) the Approved Regulator takes such steps as are reasonably practicable to ensure that it provides such resources as are reasonably required for or in connection with the exercise of its regulatory functions; and

(e) the Approved Regulator makes provision as is necessary to enable persons involved in the exercise of its regulatory functions to be able to notify the Board where they consider that their independence or effectiveness is being prejudiced.

**ANNEX B**

| Principle   | Rule  | Illustrative guidance   |
|---|---|---|
| <p><b>Part 1: Governance</b></p> <p>Nothing in an Applicable Approved Regulator's (<b>AAR's</b>) arrangements should impair the independence or effectiveness of the performance of its regulatory functions.</p> | <p><b>A.</b> Each AAR must delegate responsibility for performing all regulatory functions to a body or bodies (whether or not a separate legal entity/separate legal entities) without any representative functions (herein after '<b>the regulatory body</b>' or '<b>the regulatory bodies</b>').</p> | <p>An AAR should take all reasonable steps to agree arrangements made under these Rules with the regulatory body or, as the case may be, the regulatory bodies.</p> <p>If an AAR wishes otherwise than through its regulatory body/bodies to offer guidance to its members or more widely on regulatory matters, it should:</p> <ul style="list-style-type: none"> <li>ensure that it does not contradict or add material new requirements to any rules or guidance made by the regulatory body/bodies;</li> <li>and</li> <li>consult with the regulatory body/bodies when developing that guidance.</li> </ul> |
|   | <p><b>B.</b> The regulatory body or, if more than one, each of the regulatory bodies, must be governed by a board or equivalent structure (herein after the '<b>regulatory board</b>').</p>   |   |
|   | <p><b>C.</b> In appointing persons to regulatory boards, AARs must ensure that:</p> <ul style="list-style-type: none"> <li>a majority of members of the regulatory board are lay</li> </ul>   |   |

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|---|--|---|
|   | <p>persons; and</p> <p>the selection and appointment of a chair is not restricted by virtue of any legal qualification that person may or may not hold, or have held. The chair of the regulatory board is a lay person.</p>   |   |
| <p><b>Part 2:</b></p> <p><b>Appointments etc</b></p> <p>(1) Processes in place for regulatory board members' appointments, reappointments, appraisals and discipline must be demonstrably free of undue influence from persons with representative functions.</p> | <p><b>A.</b> All appointments to a regulatory board must be made on the basis of selection on merit following open and fair competition, with no element of election or nomination by any particular sector or interest groups.</p> <p><b>B.</b> The selection of persons so appointed must itself respect the principle of regulatory independence and the principles relating to "appointments etc" set out in this Part of this Schedule.</p> | <p>If regulatory boards do not lead on managing the appointments process, it should have a very strong involvement at all stages.</p> <p>Best practice for public appointments should be taken into account. In particular, account should be taken of the Code of the Commissioner of Public Appointments insofar as relevant.</p> <p>Appointment panels or equivalent should be established following the guidance set out in the Board's letter of 2 December 2008.</p> <p>The chair of the regulatory board (or an alternate) should always form part of that panel, unless the panel is established to select the chair (in which case another member of the regulatory board should participate).</p> |