RESPONSE TO THE LEGAL SERVICES BOARD'S

CONSULTATION PAPER ON

THE INTERNAL GOVERNANCE RULES

1 February 2018

INTRODUCTION

1. The Honourable Society of Lincoln's Inn (the Inn) is an unincorporated association of students, barristers, judges, and others connected with the law and its practice, and is one of the four Inns of Court of England and Wales. Its membership consists of (i) students, namely those who have been admitted to membership with a view to call to the Bar; (ii) hall members, namely those who have been called to the Bar, and who may be in practice at the self-employed or employed bars; and (iii) Masters of the Bench (commonly known as Benchers), namely barristers, judges and others who are elected to membership of the Inn's governing body (Council).

2. The Inn's principal public interest functions are:

    a. to call to the Bar of England & Wales those of its student members who are appropriately qualified to be called, in accordance with the requirements of the Bar Standards Board: the right of the Inns of Court to call and disbar is recognised in the definition of 'barrister' contained in section 207 of the Legal Services Act 2007;

    b. through the provision of education and training, and by the award of scholarships and the giving of other forms of financial help, to assist student members to qualify for call to the Bar and to assist them and newly called barristers to attain and maintain excellence in the conduct of their practices, including promoting the highest standards of professional ethics: in this way, the Inn contributes to achieving the Act's regulatory objectives by encouraging an independent, strong, diverse and effective legal profession (section 1(1)(f) of the Act) and by promoting and maintaining adherence to the professional principles (section 1(1)(h) and 1(3) of the Act); and

    c. through its own educational and collegiate activities, and through its membership of the Council of the Inns of Court (COIC) and involvement in the Inns of Court College of Advocacy (ICCA), to provide leadership, guidance and coordination in relation to the pursuit of excellence in advocacy: this further contributes to the Act's regulatory objectives by supporting (and realising) the constitutional principle of the rule of law, improving access to justice, protecting the interests of consumers, and encouraging the maintenance of an independent, strong and effective Bar in England and Wales (section 1(1)(b), (c), (d) and (f)).

3. In performing its principal functions as set out above, the Inn works with both the Bar Standards Board and the Bar Council. The consequences of any changes to the Internal Governance Rules (IGR) that result in a different relationship between the regulatory and representative bodies, or increase the costs of internal governance, potentially affect the Inn and its members.

4. This response is submitted on behalf of the Inn by its Regulatory Panel. Membership of the Panel comprises: Professor Stephen Mayson (Chairman), His Honour Crawford Lindsay QC (a retired judge), Sir Matthew Nicklin (a justice of the High Court), Mary Kerr (Under Treasurer of the Inn), and Timothy Lyons QC (a barrister in private practice, and member of the Inn's Bar Representation Committee). For the purposes of this consultation response, the Panel was further assisted by Mark Ockelton (Vice President of the Upper Tribunal, Immigration and Asylum Chamber), Michael Todd QC (a barrister in private practice and former Chairman of the Bar Council), and Benjamin Wood (a barrister in private practice, and Chairman of the Inn's Bar Representation Committee).

CONSULTATION RESPONSE

5. There will be other respondents to the consultation who have more detailed knowledge and experience of the working and practical consequences of the IGR. Accordingly, we confine our response to:

    a. some general observations (paragraphs 6 to 11);

    b. the definition of an applicable approved regulator (paragraphs 12 to 15);

    c. the definition of regulatory independence (paragraphs 16 to 21); and

    d. the options 1-2(c) set out in the Consultation Paper (paragraphs 22 to 37).

GENERAL OBSERVATIONS

6. We acknowledge the background that has led the Legal Services Board (the Board) to take this opportunity to review the IGR following the Ministry of Justice not accepting the recommendation of the Competition & Markets Authority to undertake a more fundamental review of regulatory independence.

7. The statement of legal context in Annex A of the Consultation Paper is helpful, and confirms that the Legal Services Act 2007 moved only partially towards securing the separation of regulation and representation. Section 30 requires the Board to ensure the separation of regulatory and representative *functions*, not of structures or entities.

8. In setting out the requirements for functional separation in the IGR, we would suggest as a matter of principle that, consistently with its generally preferred approach to regulation, the Board should seek to express those requirements in terms of outcomes rather than through specific forms of prescription or proscription.

9. The issues recorded in paragraph 25 of the Consultation Paper present matters of concern in relation to governance, particularly where agreements between approved regulators and their regulatory bodies are not being followed, or expected cooperation is not forthcoming.

10. It is also troubling that a majority of people spoken to by the Board regard cultural issues and personalities as playing a large part in the relationship between the approved regulators and their regulatory bodies: such views are potentially damaging to the notion of 'arm's length' and objective regulatory independence.

11. Based on experience so far, we feel that it ought now to be possible for the Board to oversee a clear structure that removes the suspicion of 'lawyers looking after their own' but that provides properly-informed independent regulation under a relatively simple and intelligible (but not merely formally 'transparent') structure. The public is not necessarily served by a system that does not *appear* to be sufficiently independent, even if it is possible after much investigation to conclude that it is.

THE DEFINITION OF AN APPLICABLE APPROVED REGULATOR

12. Paragraph 11 of the Consultation Paper states: "The IGR set out general requirements that apply to all [Approved Regulators], plus a schedule of more detailed requirements that apply only to 'applicable approved regulators' (AARs)." The distinction between approved regulators and AARs is only necessary because not all approved regulators under the Act are responsible for the discharge of both representative and regulatory functions. However, on the face of the current IGR, very little applies to approved regulators that are not AARs, which necessarily then skews the structure and content of the IGR to AARs. We return to this structural element of the IGR in paragraphs 26-30 below.

13. The current IGR contain an exemption for an approved regulator that discharges both representative and regulatory functions where 'the primary reason to be regulated by that Approved Regulator' is not to practise a reserved legal activity. The original justification for the exemption is said to be founded on a wish to retain proportionality and flexibility in relation to those approved regulators (such as the Institute of Chartered Accountants in England & Wales (ICAEW)) whose practitioners undertake reserved legal activities as a service incidental to their main professional activities.

14. We regard the exemption of some approved regulators who would otherwise be AARs as questionable. We refer to the decision of the Lord Chancellor in September 2017 not to approve the ICAEW as an approved regulator in respect of additional reserved legal activities. We note that his reasons included concerns about regulatory independence, and that he emphasised the importance to the rule of law, and to the public and consumer interest, that regulatory functions must be, and be seen to be, suitably independent from representative functions.

15. We would therefore encourage the Board to remove the 'primary reason' exemption from the definition of an applicable approved regulator. This would ensure that all of the approved regulators of reserved legal activities would be subject, in the public interest, to the same internal governance principles where they discharge both representative and regulatory functions.

Question 12: Do you agree that the definition of AAR should be revised? Why or why not? If so, how do you think the definition should be revised, and why?

We agree that the definition of an applicable approved regulator should be revised. The 'primary reason' exemption in the current definition is not consistent with the intended outcomes of the Legal Services Act in relation to actual and perceived independence between representative and regulatory functions. The definition should therefore be revised to apply to all approved regulators that are responsible for the discharge of regulatory and representative functions.

THE DEFINITION OF REGULATORY INDEPENDENCE

16. Consistent with the intention of the Legal Services Act and best regulatory practice, the principle of regulatory independence should rightly be a key feature of the IGR. To the extent that the Act refers to independence as between approved regulators and their regulatory bodies, it is expressed in terms that (sections 29(2) and 30(1)):

    (a) the exercise of regulatory functions must not be prejudiced by representative functions; and

    (b) decisions relating to the exercise of regulatory functions must, so far as reasonably practicable, be taken independently from decisions relating to the exercise of representative functions.

17. In principle, therefore, the principle of regulatory independence should be expressed and defined in the same way.

18. There is no reference in the Act to 'undue influence or control', and it is accordingly not clear why the IGR import this new concept – particularly into such a central role. We note that 'control' is not defined in the IGR (or in the Act).

19. The IGR definition of 'undue influence' is "pressure exercised otherwise than in due proportion to the surrounding circumstances, including the relative strength and position of the parties involved, which has or is likely to have a material effect on the discharge of a regulatory function or functions". By referring to 'pressure exercised otherwise than in due proportion', this definition accepts that a relationship of pressure between an approved regulator and regulatory body is acceptable and to be accepted: the only question then is whether that pressure is exercised 'otherwise than in due proportion'.

20. We do not consider that the premise of the IGR should be that the relationship between approved regulator and regulatory body is predicated on pressure. Such a starting point presumes that a regulatory body is not to be expected to make its own free, considered and independent decisions and judgements in the absence of some pressure from the approved regulator.

21. Further, the pressure exercised by an approved regulator must not be 'otherwise than in due proportion'. It seems conceivable to us that because pressure can be exercised in many subtle ways, it might not be significant enough to be 'out of proportion' but could nevertheless be considered inappropriate. If a notion of undue influence and control is retained in the IGR, we would suggest that the Board should consider expressing it in terms of appropriateness rather than proportionality.

Question 14: Do you agree that the definition of regulatory independence should be revised? Why or why not? If so, how do you think the definition should be revised, and why?

For the reasons given above, we agree that the definition of regulatory independence should be revised (or possibly even be removed: see paragraph 35 below). The current definition is not consistent with the Legal Services Act 2007, and introduces an unnecessary, prominent and limiting concept of undue influence or control. If retaining a substantive definition of regulatory independence is felt to be appropriate, revision should be considered that expressly adopts and remains consistent with the language of section 30 of the Act. To the extent that any reference to undue influence or control might remain in the IGR, it should be as a reference to circumstances in which the principle of regulatory independence is likely to be

compromised or undermined, and should refer to the inappropriateness of any pressure or influence exerted rather than to a lack of due proportion.

An alternative formulation of the definition of regulatory independence might be:

> In these Rules, a reference to the "principle of regulatory independence" is a reference to the requirements that an Approved Regulator must:
>
> (a) take 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;
> (b) have in place arrangements which ensure the persons involved in the exercise of its regulatory functions are, in that capacity, able to make representations to, be consulted by and enter into communications with, the Board, the Consumer Panel, the OLC and other approved regulators;
> (c) where relevant, ensure that the exercise of its regulatory functions, or the exercise of the powers of those persons involved in those functions, is not prejudiced by its representative functions;
> (d) where relevant, ensure that decisions relating to the exercise of its regulatory functions are so far as reasonably practicable taken independently from decisions relating to the exercise of its representative functions; and
> (e) make such 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.

OPTIONS FOR THE FUTURE OF THE IGR

22. We consider that Options 1 (no change) and 2a (incremental change) would offer insufficient scope for addressing the concerns identified in the Consultation Paper, and that the revisions that we would wish the Board to consider in response to Questions 12 and 14 above require more extensive change to the IGR.

23. On the other hand, we consider that Option 2c and adopting a new approach might be premature in the absence of the more fundamental review of regulatory independence that the Ministry of Justice has, at least for the time being, declined to undertake.

24. We therefore conclude that in all the circumstances Option 2b, and more extensive change within the current IGR framework, would represent a reasonable approach.

25. As well as incorporating suggestions for the revision of the current definitions of an applicable approved regulator and of the principle of regulatory independence, we would invite the Board to consider the following observations when considering more extensive changes to the IGR.

26. Rule 6 of the IGR is written to apply to all approved regulators. However, it is phrased by reference to the principle of regulatory independence, which is restricted to circumstances of approved regulators having both regulatory and representative functions. In effect, therefore, Rule 6 can only apply to AARs: it would be pointless for those approved regulators that do not have representative functions to have in place arrangements that observe and respect a principle that is defined in such a way as not to apply to them[1].

27. Rule 7 then applies to the arrangements in place under Rule 6. If an approved regulator does not need to make arrangements under Rule 6 because it has no representative functions, Rule 7 cannot apply either.

28. Rules 8, 9 and 10 are expressly limited to AARs.

29. Thus, there are no rules of substance in the IGR that, on a proper reading of them, apply to approved regulators that are not AARs. This would appear to be a serious shortcoming in the drafting of the IGR. There are, for instance, some elements of Rule 7 (such as (a), (d) and (e)) that could be relevant to an approved regulator that is not an AAR, and there are other aspects of the IGR currently applicable only to AARs that we think the Board could appropriately extend to all regulatory boards.

30. Rule 8 applies the Schedule to the current IGR only to AARs. However, it contains requirements and material that should apply equally to the governance arrangements of all approved regulators, without being confined to the more limited context of undue influence. These include, for example, 1B (a regulatory board), 1C (lay chair and lay majority), 2B and 2C (responsibility for elements of the appointments, etc process), 2D and 2E (management and dismissal of regulatory board members), and 3 (defining and implementing a strategy, and ensuring adequate and appropriate resourcing). In addition, the references to section 28 in the illustrative guidance for 3A and 3B should apply more generally and appear in the main body of the IGR, given that section 28 imposes obligations on all approved regulators.

1. Although approved regulators that are not AARs might still engage with representative bodies, the principle of regulatory independence in Rule 1 refers to 'representative functions', for which Rule 2 incorporates the definition in section 27(2) of the Act. This definition applies only to functions that an approved regulator has in connection with the representation of the interests of persons regulated by it. Consequently, only an AAR would fall within the definition.

31. By restructuring the IGR to include the more generalised expectations referred to in paragraphs 29 and 30 above, the IGR could contain a more robust and explicit set of requirements and expectations of all approved regulators. In meeting those requirements and expectations, AARs would have the additional responsibility imposed by the IGR of doing so without breaching or compromising the 'independence' requirements of the Rules.

32. Further, the IGR could then be expressed in terms of outcomes. For example, the governance rules of *any* approved regulator should be expressed in such a way that (cf. current requirement 2A) all appointments to a regulatory board should 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 group. As part of assessing whether or not these governance rules were compliant or not with the IGR, the Board would no doubt conclude that they were not if it thought that arrangements for appointments would not secure this outcome, or appeared to it to be contrary to the principle of regulatory independence (because, to take a perhaps extreme case, the majority of the members of an appointment panel were representatives of an AAR).

33. By focusing the IGR more on outcomes, subject to some general principles for best practice internal governance and for regulatory independence, the Board could place more responsibility on regulatory bodies to formulate governance arrangements and their own internal governance rules, to be approved by the Board. The IGR could contain provision for an approved regulator (and other interested parties) to be consulted and to make representations to the Board as part of the approval process. Such arrangements and rules could then be more appropriately and specifically adapted to the circumstances, needs and resources of the different regulatory bodies: regulatory bodies are likely to be best placed to assess any risks to their independence in the relationship with their approved regulator.

34. We do not therefore believe that Option 2b necessarily implies "introducing more detailed rules" (cf. paragraph 63 of the Consultation Paper). On the contrary, the IGR could maintain a set of principles to be followed, reinforcing the outcomes and indicia of independence that the Board would wish to see in the governance rules and behaviours of approved regulators and regulatory bodies. By placing responsibility on the regulatory bodies to submit their own governance rules, the detail and relevant content would be left to each regulatory body to determine, subject to approval by the Board. These arrangements would reflect the approach, circumstances, information needs and resources judged by each regulatory body to be appropriate. As a consequence, the costs to practitioners in different professions or sectors within the legal services market could be more closely aligned and proportionate to the needs and risks of their areas of practice.

35. The IGR could then adopt a different structure that did not require a definition of the principle of regulatory independence. For example, rather than the current Rules 6 and 7, new IGR could contain the following general statement (or alternatively refer to sections 28 and 30 of the Act without directly importing the language):

> In discharging its obligations under these Rules, an Approved Regulator must:
>
> (a) so far as is reasonably practicable, act in a way which is compatible with the regulatory objectives, and which it considers most appropriate for the purposes of meeting those objectives;
> (b) have regard to the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed, and any other principles appearing to it to represent the best regulatory practice;

(c) take 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;
(d) have in place arrangements which ensure the persons involved in the exercise of its regulatory functions are, in that capacity, able to make representations to, be consulted by and enter into communications with, the Board, the Consumer Panel, the OLC and other approved regulators;
(e) where relevant, ensure that the exercise of its regulatory functions, or the exercise of the powers of those persons involved in those functions, is not prejudiced by its representative functions;
(f) where relevant, ensure that decisions relating to the exercise of its regulatory functions are so far as reasonably practicable taken independently from decisions relating to the exercise of its representative functions; and
(g) make such 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.

36. Additional rules, or a schedule, could set out those aspects of internal governance that the Board would wish a regulatory body's governance rules to address (cf. paragraphs 29 and 30 above). Each regulatory body should then be required to submit a set of governance rules to the Board for approval (subject to appropriate consultation requirements, including with the approved regulator).

37. In these circumstances, we believe that future assurance of compliance should be part of the Board's regulatory performance assessment. We think that there is, potentially, insufficient clarity or consistency of approach in the use of third-party assurance. Further, while the reintroduction of dual self-certification (DSC), using separate reporting to the Board by an AAR and its regulatory body, might help to expose any disagreements or differences of opinion, on balance we feel that the Board's role in monitoring compliance actively and directly is important in assessing both the fact and perception of regulatory independence – and, given the Board's oversight responsibilities under the current Act, this is an important part of securing public confidence in the regulatory framework.

Question 9: Do you agree with option 2b: making more extensive changes to the IGR? Why or why not?

We agree with this option. It is more likely to meet stakeholders' objectives, and the concerns expressed about regulatory independence by the Board, some regulatory bodies, the Competition & Markets Authority, and the Ministry of Justice, than Options 1 and 2a. In addition, unlike Option 2c (a new approach), it is less likely to pre-empt changes that might result from a more fundamental review and reform of the approach to regulatory independence.

By restructuring the IGR to include more generalised expectations and outcomes, the IGR could contain a more robust and explicit set of requirements and expectations of all approved regulators. In meeting those requirements and expectations, AARs would have the additional responsibility imposed by the IGR of doing so without breaching or compromising the 'independence' requirements of the Rules.

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should then be required to submit a set of governance rules to the Board for approval (subject to appropriate consultation requirements, including with the approved regulator).

Question 22: Do you agree with IGR compliance becoming part of regulatory performance assessments? If so, why? What do you anticipate would be the impact of IGR compliance becoming part of regulatory performance assessments, and why?

We believe that IGR compliance should be part of the Board's regulatory performance assessment. We think that there is, potentially, the opportunity for greater clarity and consistency of approach than in the use of third-party assurance or the reintroduction of dual self-certification. On balance, we feel that the Board's role in monitoring compliance actively and directly is important in assessing both the fact and perception of regulatory independence – and, given the Board's oversight responsibilities under the current Act, this is an important part of securing public confidence in the regulatory framework.

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