Note of Regulatory Independence Stakeholder Workshop

Wednesday 2009 July, 2pm – Legal Services Board, Southampton Row WC1B 4AD

Between its two formal consultations on regulatory independence[1], the Legal Services Board (LSB) held a workshop to help to develop its policy proposals. Discussion, which was based on a briefing paper circulated prior to the event, built on the LSB's early analysis of submissions received after its March-June consultation exercise. That paper is included as an ***Annex*** to this note.

The workshop was attended by a total of twenty eight stakeholders representing the following sixteen organisations:

- Bar Council
- Bar Standards Board (BSB)
- BSB Consumer Panel (also representing LSB Consumer Panel)
- Chartered Institute for Patent Attorneys (CIPA)
- Citizens Advice
- Consumer Focus
- Council for Licensed Conveyancers (CLC)
- Institute of Legal Executives (ILEX)
- Institute of Trade Mark Attorneys (ITMA)
- Intellectual Property Regulation Board (IPReg)
- Master of the Faculties (MoF)
- Ministry of Justice (MoJ)
- Solicitors Regulation Authority (SRA)
- The Law Society (TLS)
- Which?

The workshop was divided into three parts:

A. an **introduction** by LSB Chairman, David Edmonds, setting out the objectives for the event **and a plenary discussion** on the key principles set out in Section A of the paper circulated ahead of the event;

B. three separate **focus groups**, each discussing a specific area of proposals covered in Section B of the briefing paper (namely regulatory board appointments etc; the control and management of resources; and the mechanics of implementation); and

[1] On 25 March 2009, the LSB published a consultation paper, *Regulatory Independence*, which sought responses by no later than 26 June 2009. Subsequently, the LSB issued a supplementary consultation paper, *Internal Governance and Practising Fee Rules*, on 16 September 2009.

C. a **final plenary discussion**, at which the conclusions from each focus group discussion could be summarised and any additional points could be raised.

The following is a summary of the notes taken of the discussions in each of the three parts of the workshop.

A. Introductory plenary session

The Chairman of the Legal Services Board welcomed those present to the workshop. He highlighted the importance to the LSB of the proposals on regulatory independence and thanked all those who had participated thus far in the consultation process.

As part of the introduction, the Chairman:

- explained the arrangements for the workshop event;
- summarised briefly the evidence submitted in response to the recent consultation exercise[2]; and
- set out the key thinking covered in the paper that had been circulated to all attendees.

The Chairman then opened discussion to the floor. The following points were made (organisation noted in brackets at the start of each bullet):

- (SRA) the proposals set out by the LSB in its consultation document and subsequent paper circulated in advance of the event were broadly on the right lines. The LSB was urged to take into account the size and scale of respective approved regulators when deciding on (a) what 'reasonably practicable' meant in practice and (b) how quickly implementation of the final rules should be achieved.
- (ILEX and TLS) it would be wrong for the LSB to consider approved regulators like ILEX and TLS as solely responsible for representative functions where certain regulatory functions have been delegated to a regulatory arm. While the delegation must be proper and effective, the approved regulator remains responsible in law for the discharge of its functions in accordance with the Legal Services Act.
- (Consumer Focus) the consumer emphasis of the LSB proposals is very welcome and consumer organisations would be very keen to hear from approved regulators whether they are happy for the status quo to be challenged, and from the LSB about whether the status quo needs to be challenged.
- (CIPA) with the focus on regulatory independence, it is important to highlight that those carrying out roles which include the 'representation functions' need to continue

[2] See submissions lodged in response to the consultation at http://www.legalservicesboard.org.uk/what_we_do/consultations/closed/submissions_regulatory.htm and the Summary of Responses (published subsequent to the Workshop being held) at http://www.legalservicesboard.org.uk/what_we_do/consultations/closed/pdf/regulatory_independence/response_160909.pdf.

to play a crucial part in the regulatory debate. This is what "profession-led" regulation means. The voice of organisations like CIPA and its members must not be drowned out by the work to achieve regulatory independence.

B. Focus groups discussions

(i) Appointments, appraisals, reappointments and discipline

This discussion was chaired by Bruce Macmillan, Legal Services Board's General Counsel.

Participating in the discussion were representatives of the following organisations:

- Bar Council
- BSB
- BSB Consumer Panel
- Consumer Focus
- ILEX
- ITMA
- MoJ
- The Law Society

In summary, participants broadly agreed with the thrust of the draft rules and guidance proposed by the LSB. Several participants commented that the LSB was "on the right track" and the consultation document was a "good analysis of rules versus guidance". However, in some areas, such as lay majority for regulatory boards within approved regulators' structures, some attendees were keen to see some of the detail moved from rules to guidance in order to allow greater flexibility to address individual organisation's circumstances.

There were several issues that the participants debated and discussed. They include:

A lay/non-lawyer majority on the Board being imposed as a rule by the LSB.

- Several participants (ITMA/TLS/BC/ILEX/BSB) voiced concern over any *requirement* to provide for a majority of lay/non-lawyer membership on their regulatory boards. Instead, the decision should ultimately be up to the approved regulator to decide who is the 'best for the job' (BSB/ITMA/TLS) both in respect of the lay/non lay mix of members but also in respect of whether the chair should be lay. This was emphasised particularly by the smaller approved regulators, which it was suggested have a more limited pool of qualified and experienced people to choose from (ITMA) and where a particular skill set or other appropriate balance (e.g. equality and diversity) would be harder to obtain.

- However, one participant was strongly in favour of regulatory boards consisting of a lay/non-lawyer majority (CF). Another representative argued for a requirement for lay Chair on the basis that although "lay members do not tend to vote as a group, and lawyers don't either, they have a shared culture. So we need a robust group of lay members to challenge the professionals – and lay leadership will be important in this regard". It was further commented that it was important that the non-lawyers possessed appropriate skills and not simply drawn as a group of the non-legal "great and good" (BSB-CP).

The suggested guidance of "appointees should not have had a 'rep' role for at least 5 years"

- Several participants indicated that the 5 year stand down period for a candidate with a previous representative role was too long and that it should not be imposed as a rule nor recommended as guidance – the suggestion being that it was better to explain why someone was appropriate rather than create a blanket restriction (ITMA/ILEX/BSB/LS). The guidance on this topic was described as a significant restriction (BSB) and would "...result in some well qualified people denied for appointment to the Board". For example, it was suggested that all the existing legally-qualified SRA board members would have been ineligible" (TLS).

- Several participants agreed that it would be useful to have more clarification on what a representative function is and in particular who should be 'barred' from transferring to regulatory functions (ITMA/BC/TLS). These participants also suggested that rules/guidance should not be too restrictive. One (TLS) commented that the available pool of people with an interest in regulatory issues who had not already shown an interest in representative activity would be very small and that it might be positively harmful to exclude, for example, someone who had experience in a black and minority ethnic (BME) representative role from a national committee.

- One representative highlighted the importance of maintaining proportionality. The LSB needs to ensure the rules on appointments do not shut out appropriate and potentially valuable people, as this would be to the detriment of the approved regulators – and in particular the smaller ones (MoJ).

Defining the split between the representative and regulatory functions of an approved regulator- particular focus on reappointments

- It was suggested that, as the Clementi 'Model B+' had been adopted by the Legal Services Act's framework, personnel from the approved regulator itself, rather than its regulatory arm, would have to have some engagement in committees and decision-making and would have to show their impartiality in exercising that function (BC). Reappointments were felt to be a particular area of risk, however. If the representative body's involvement was too powerful, regulatory board members – or staff – might seek to act in ways that might make representative approval of their reappointment easier. The idea that those with representative functions should be allowed to make submissions but not be part of the (re)appointment committee was suggested.

Clarification/clear definitions of terms related to the Act

- All participants agreed that the terms 'lawyer' and 'lay person/non-lawyer' needed to be defined clearly. In particular, clarity was thought necessary around the point at which a person would start to be considered as a lawyer (e.g. graduate, trainee but not practising or otherwise) and if a lawyer could ever cease being categorised as such. One participant highlighted the problem of defining lawyers in terms of being a practitioner covered by the particular approved regulator in question. Difficulties were thought to arises because of the potential for any approved regulator to change the

range of reserved legal activities they cover, particularly in the context of Legal Disciplinary Partnerships and Alternative Business Structures.

- Other terms were singled out as requiring more definition or interpretation by the LSB. These included 'representative responsibility' and 'appropriate independence', both of which were coined in the paper circulated to attendees prior to the Workshop.

Independence – Perception vs. Practice

- A theme that ran through the discussion was, although not expressly stated as such, the trade off between the perception of independence in eyes of third parties compared to the reality of independence in practice. Could a lawyer trying to be impartial ever truly discard his or her underlying experience and training enough to be a suitable proxy for a robust objective/lay person? One participant suggested that lawyers tend to think instinctively in terms "we", which is why the Legal Services Act had a 'once a lawyer, always a lawyer' test for membership of the LSB (BSB-CP).

(ii) Control and management of resources

This discussion was chaired jointly by Fran Gillon and Julie Myers, respectively Director of Regulatory Practice and Director of Corporate Affairs at the Legal Services Board.

Participating in the discussion were representatives of the following organisations:

- Bar Council
- BSB
- Citizens Advice
- CIPA
- ILEX
- MoJ
- SRA
- The Law Society
- Which?

In summary, participants suggested that the LSB must concentrate on ensuring that the final rules it makes take account of the different sizes of organisations across the sector. Irrespective of issues of size, however, care should be taken to keep any additional burdens to a minimum. In particular, care should be taken to avoid duplication of effort.

In terms of details, discussion included:

"Reasonable" resources for regulatory functions

- One attendee (BSB) suggested that the LSB must look to ensure, through its rules and its proposed dual self-certification arrangements, that regulatory functions within each of the approved regulators were resourced sufficiently. In particular, the LSB should be satisfied that regulatory arms had sufficient control over resources required to meet the strategies adopted.

- It was also suggested (TLS/BSB) that approved regulators should be looking at planning 3-5 years ahead when determining their reasonable need, rather than just operating from year to year. The issue of additional resources being available in exceptional circumstances was also raised (BSB). The LSB should look to assure

itself that, in the event of an extraordinary mid-year disciplinary case (for example), a regulatory arm would be able to access resources free from any unreasonable constraint.

Budget setting

- Another attendee (SRA) said that there were some "easy" issues in relation to resourcing – e.g. it is broadly agreed that regulatory arms should develop their own strategies and business plans, and determine how they should spend allocated budgets against such strategies/plans. The harder part was the process for setting the budget and dealing with shared services. The attendee suggested that there needed to be checks and balances which enabled the delivery of an agreed budget which did not lead to appeals for redetermination. This 'checks and balances' issue masked a lot of detail which would need to be worked through by approved regulators and their regulatory arms, with oversight from the LSB.

- There was broad consensus that nobody wanted to see the LSB "holding the ring" between approved regulators and their regulatory arms throughout budget settlement processes. However, it was suggested that people within the various organisations did need to be afforded the protection of whistle-blowing. Organisations also needed the protection of the right of appeal (TLS).

- One respondent (BSB) said that more thought needed to be given to modelling different scenarios and how they would be dealt with. It was suggested that the LSB should offer some "imperatives" for regulatory arms which if included in the budget could not be denied as part of the budget approval process.

- In relation to specific projects, one attendee (TLS) suggested that there should be a normal requirement for a cost benefit analysis to be undertaken to ensure that proposals were both appropriate and good value for money. This represented good practice, not disproportionate regulation.

Shared services

- Insofar as "shared services" or corporate services from a common provider was concerned, it was suggested that it would be sensible for larger approved regulators to establish an independent oversight structure, made up of members from the regulatory and representative arms and also independent members. Again, the need for checks and balances was emphasised. Any such oversight structure should ensure that constituent parts have "parity of esteem" – and it should be for an approved regulator to demonstrate to the LSB that its structures/processes meet the principles, rules and guidance laid down (SRA).

- In terms of the smaller approved regulators, it was suggested that establishing corporate structures to manage and oversee common service provision was neither proportionate nor feasible. The smaller approved regulators represented at the event (including the regulatory arms) said that they saw no need to create additional structures. Instead, approved regulators could rely on service level agreements and the like in order to regulate their own internal processes (ITMA/CIPA/IPREG).

Miscellaneous issues

- Attendees from some of the smaller approved regulators (IPREG/ITMA/CIPA) highlighted that approved regulators represented some who were not registered members (and so regulated by the regulatory arm) which could give rise to problems. In terms of resources where approved regulators had a duty to underwrite any overspend by regulatory arms, a body of people wider than the narrow regulated community would foot the bill.

- One attendee (Which?) suggested that it was important to recognise that perceptions of those outside the sector – including consumer – were important. If 'representative arms' were seen as holding the purse strings, consumer confidence would not return. This issue was considered to be one of the most important in terms of making the new regime work effectively, and for being seen to work effectively.

(iii) <u>The mechanics of implementation</u>

This discussion was chaired by Crispin Passmore, Legal Services Board's Director of Strategy and Research.

Participating in the discussion were representatives of the following organisations:

- Bar Council
- BSB
- CIPA
- CLC
- MoF
- MoJ
- SRA
- The Law Society

In summary, attendees indicated broad support for and commitment to the proposed rules and the spirit laying behind them. There was also a broad consensus about the need for the LSB to adopt a risk-based approach to implementation. Importantly, a commonly expressed view was that the LSB needed to be clear about the practical implications of rules it proposes/makes. In particular, the LSB must work hard to understand budgeting cycles for each approved regulator so that its practising fee rules work smoothly. Many attendees also pointed out that approved regulators have differing capacities to meet the LSB's proposed agenda and said that the LSB should proceed in that context. The LSB should also be mindful of the other challenges facing approved regulators, which will have a bearing on the ability of all organisations to implement rules brought forward by the Board.

In terms of detail, discussion included:

Timing

- In respect of Internal Governance Rules (IGRs), a number of attendees highlighted potential difficulties in meeting the proposed 31 March 2010 deadline for submitting and publishing compliant governance arrangements, requisite evidence, and (if/as required) implementation plans.

- Much of the discussion revolved around the level of uncertainty as to the amount of work to be done before the deadline, the scale of which would be dependent on how prescriptive the LSB is going to be in setting both the framework for IGRs and the evidence requirements. Because, the approved regulators are at different starting points in this process, a rigid deadline might entail difficulties across the sector. Some commented that it would be helpful if the LSB could set out the evidence requirements as early as possible so that the approved regulators could begin to plan their work.

- It was made clear that the LSB intended to approach the implementation project in a proportionate manner, not an overly bureaucratic or prescriptive way. The group was asked whether the LSB should set a longer timeline and be more prescriptive or a shorter timeline and ask approved regulators to assess where they are positioned in terms of risk (of the impact of any residual areas of non-compliance) at the given deadline? This would mean varying timelines for full compliance, taking into account actual risk and individual AR resources. There was consensus that the latter was the most sensible and practicable approach. Suggestions made included that the LSB should take account not only of the size of an approved regulator in terms of capacity and sectoral impact, but also their various starting points, their board cycles, employment contracts, and other such issues.

Costs and pace of change

- Much of the discussion around cost of meeting the requirements related to the proposed timeframe and the consequent short-term pressure points. One attendee (Bar Council) highlighted the current resource pressure as a result of (i) the levy, and (ii) resourcing new LSB/LSA requirements. If the required pace to implement change results in the necessity to purchase external resource there would need to be a discussion about this. Another attendees (TLS) added that the amount of information required should be made clear in advance. The attendee also made the point that given the broad support for the principles underpinning the implementation of IGRs the LSB's eventual timetable needs to be reasonable.

- In relation to smaller regulators in particular, the point was made (by MoF) that there are increasing resource demands, largely attributable to new requirements of the LSB and the Act – for example the necessary information gathering and consultation responses. Where costs have traditionally been low, there was a concern that some practitioner members will leave the profession as a result of this cost burden, which would have a detrimental impact on consumers.

- One attendee (CLC) suggested that too much focus on issues around regulatory / representative conflict may cause all involved to lose sight of good regulatory principles. All approved regulators have an obligation to further the regulatory objectives and that should be the priority.

- It was generally agreed by attendees that it would be preferable for the LSB to work on the presumption that approved regulators are going to be "grown up" about regulatory independence. The risk of anticipating conflict is that we inadvertently drive behaviour towards it. The LSB's proposed principles-based approach was

designed to meet that point. However, where any approved regulator is seen to be 'dragging its feet', the LSB's enforcement powers will be available.

Implementation of s.51

The ensuing discussion covered the following points:

- Because of the centrality of practising fees to general resourcing requirements, attendees suggested that rules should avoid excessive prescription and inflexibility.
- Unexpected expenditure required by the regulatory arm from the approved regulator in-year is something the LSB should consider making provisions about in its rules.
- In terms of timing, most if not all approved regulators have complex budget cycles, which can include the listing of actual spend retrospectively in annual accounts. It would be helpful if these retrospective accounts (as opposed to projected) could be used for the purposes of s.51 fee approval.

C. Concluding plenary session

The final session started with each of the LSB Directors who had facilitated the break-out discussion groups feeding back on the discussions that had taken place. Discussion was then opened to the floor and the following points were among those raised:

- There was positive feedback on the Workshop event, which was considered by many to have been helpful. Some attendees suggested that this model should be adopted by the LSB in future consultation exercises.

- There was discussion about terminology and in particular about use of the phrase "representative" when talking about approved regulators. Because approved regulators were designated as such under the Legal Services Act, it was misleading to talk about that which was not hived off to the regulatory arm as being purely 'representative'.

- Some attendees, particularly those from smaller approved regulators, asked about the degree to which approved regulators could work with (and rely on the support of) the LSB when working towards compliance. Where an approved regulator had particularly limited resources, advice, guidance and assistance from the LSB was something that would be welcomed. The LSB providing Board or senior staff members for appointments panels was one suggestion made.

- While accountability and transparency was an issue for approved regulators, it was also an issue for the LSB in terms of its own work.

The Workshop was closed by David Edmonds, who set out the indicative timetable for the remaining consultation exercise and then thanked all attendees for the valuable contributions they had made, both at this Workshop and more generally.

Annex

Regulatory Independence – Stakeholder Workshop

Wednesday 29 July 2009, 2pm – Legal Services Board, Southampton Row WC1B 4AD

The LSB's consultation on draft Internal Governance and Practise Fee Approval Rules finished on 26 June. The forty submissions received are available online (at http://www.legalservicesboard.org.uk/what_we_do/consultations/closed/submissions_regulatory.htm). A summary of responses will be published in September, alongside the final iteration of draft rules, which will be subject to further consultation. The LSB will make its final rules under sections 30 and 51 before the end of 2009.

This draft paper, which has not been approved by the Board, builds on early analysis of submissions received and is intended to form the basis of discussions at the 29 July event.

Format of event: After an introductory plenary discussion focusing on overarching principles, breakout sessions will focus on one or more of three issues, namely proposed rules underpinning the principles on **appointments** etc and **resource management** etc and determining the **mechanics** of implementation.

A. The principles of independence – for discussion at Plenary session

Consultation responses have highlighted, to an extent at least, a lack of consensus on the precise scope of rules to be made under section 30. To be clear, the LSB considers that:

- in making/applying the rules, which the LSB is *obliged* to make, the LSB must act in a way which (1) is compatible with the regulatory objectives[3], (2) is considered by the LSB to be most appropriate for meeting those objectives[4], (3) has regard to the principles of better regulation[5] and (4) has regard to the principle that its principal role is one of oversight[6];
- the public interest is served by ensuring, insofar as is reasonable, confidence (incl. of consumers and lawyers) in the regulatory arrangements applicable to lawyers;
- the purpose[7] of the Internal Governance Rules is to ensure that the exercise of an AR's regulatory functions is not prejudiced by its representative functions and that decisions relating to the exercise of an AR's regulatory functions are – so far as reasonably practicable – taken independently from decisions relating to representative functions;
- the objective behind the rules is to ensure that they achieve their purpose and are perceived (by *reasonable* stakeholders) to achieve that purpose; and
- the requirement to make rules gives the LSB discretion – to be exercised reasonably and in line with the above, including in relation to proportionality – to determine the necessary detail.

[3] LSA07, section 3(2)(a).
[4] LSA07, section 3(2)(b).
[5] LSA07, section 3(3)(a) and (b).
[6] For example, see LSA07, section 49(3).
[7] LSA07, section 30(1)(a) and (b).

Drawing on the above, the LSB considers that it should exercise its discretion so as to ensure in particular that people with representative functions should not exert undue influence or control over the discharge of regulatory functions[8] – and prevent the appearance or perception that there is any such undue influence/control.

Accordingly, we will expect ARs to delegate responsibility for performing all their regulatory functions to a body without any representative function(s) or member(s) and which is not unduly influenced by any person(s) exercising such functions. In particular:

- **appointments, appraisals, reappointments and discipline** – the appointments etc process for regulatory board members must produce a board that is demonstrably free of representative control, and of undue influence from any body, sector or constituency that could reasonably be construed as representative of the regulated community (or any part(s) of it);
- **strategy and resources** – a regulatory board must have the freedom to define a strategy to meet its delegated responsibilities. This should include access to resources reasonably required to meet the strategy it has adopted, effective power of control over those resources and the freedom to govern all its internal processes and procedures – including communications;
- **residual oversight** – while it is imperative that ARs retain an oversight role in relation to performance of delegated regulatory functions, such oversight must not unduly influence – nor be seen to unduly influence – persons exercising those delegated functions. Oversight must also, at all times, remain proportionate.

Before considering the detail necessary to underpin principles, we would like you to consider these proposals and to suggest any changes thought necessary or desirable.

B. Issues of detail – for discussion in breakout groups

Our consultation paper included a draft set of rules. A lot of submissions included helpful feedback, which we are now considering. It is not our intention to set out a complete new set of draft rules at this stage – although we will share our thinking as we work towards the next consultation period in September. However, it would be useful to focus on some elements of the detail necessary to underpin/implement our principles.

Insofar as **underpinning** the principles, what follows is based on two key assumptions:

- the risk which section 30 rules seek to mitigate/avoid is the reality or perception of undue influence over regulatory affairs by representative people/bodies; and

- the principles outlined in section A are reasonable for the LSB to adopt.

The tables below suggests how some of the principles identified could be converted into rules and/or supporting guidance, first on appointments etc and second on control and management of resources. In terms of status, rules must be adhered to. Supporting

[8] 'Regulatory' and 'representative' functions are defined in s27 of the LSA07. Also see section 21(1).

guidance will be for ARs to have regard to, explaining publicly to the LSB where and why (if at all) they do not follow it. As a general rule, the less that guidance is observed by any AR, the more the LSB will look to monitor the AR when it comes e.g. to regulatory reviews.

(i) Appointments etc *– Breakout Group 1*

Principle	**Suggested Rule**	**Suggested Guidance**
Processes for reg board members' appointments, reappointments, appraisals and discipline must ensure a Board that is demonstrably free of rep control, and of undue rep influence For the avoidance of doubt, it is not improper for 'representative' involvement (indeed, such involvement can be beneficial), but it should never give rise to the reality or perception of 'control' or 'undue influence'	Subject to the following rules, all decisions on appointments etc to be made on basis of merit, with no element (in respect of appointments) of election, or of nomination to 'represent' sectional interest(s)	Best practice for public appointments should be observed. In particular, account should be taken of OCPA code, with any departures explained to the LSB and publicly
	Appointments must be made with regard to desirability of securing broad range of applicable skills	The range of skills set out in LSA07 Sch 1, applicable to LSB, serves as a useful template. Most importantly the Board should include members with a knowledge of and expertise in regulation, not just a familiarity with the sector
	However: (1) no appointee should have any parallel 'rep' function; (2) there should be no lawyer majority on Boards; and (3) there should be no requirement for Chair/equivalent to be a lawyer	Appointees should not have had a 'rep' role for at least 5 years Perception of independence might be best served by a majority of non-lawyers Chairs should be appointed on merit, after considering qualities most beneficial, without consideration as to qualifications held/not held – however case for lay chair is less if Board has lay majority
	People responsible for decisions on appointments, reappointments, objective appraisal and discipline (including dismissal) should similarly demonstrate appropriate independence.	OCPA-compliant panels should have clear minority of rep members. For reappointments, decisions should be guided by objective appraisals and desirability of continuity While rep bodies can be consulted on appraisals, rep people should not be involved formally in agreeing the outcome, or in pay reviews If reg arm does not lead the process, it should have very strong involvement at all stages

		Reg Chair should always serve on panels, unless the panel is to select the chair (in which case another member should be allowed to participate)
	LSB must agree any proposed dismissal and be consulted on any proposed disciplinary action	LSB concurrence would be preferable in any sub-dismissal disciplinary matter

***Objective of breakout group 1*: Consider and comment on these suggested proposals. Additional *questions* to consider include: (a) whether the LSB should define 'lawyer' and 'non-lawyer' and, if so, how; and (b) whether rules or guidance should encourage or require at least one of 'lay' majority or 'lay' chair?**

(ii) ***Strategy and resourcing*** *– Breakout Group 2*

NB the required delegation assumed here would cover responsibility for performing all regulatory functions (per section 27) and so the management of all regulatory arrangements (per section 21).

Principle	Suggested Rule	Suggested Guidance
Reg arm must have the freedom to define a strategy to meet its delegated responsibilities. This should include: • **access to resources** reasonably required to meet the strategy it has adopted; • **effective control** over those resources; and • freedom **to govern all its internal processes** and procedures. Nothing in the ARs regulatory arrangements, or in pursuance of those arrangements, should impair the independence or effectiveness of its regulatory arm For the avoidance of doubt, it is not improper for 'representative' involvement (indeed, such involvement can be beneficial), but it should never give rise to	*General power* An AR's arrangements should provide the reg arm with the power: • to determine and implement a strategy entirely of its own choosing in order to discharge the responsibilities delegated to it; and • to do anything [*within budget*] calculated to facilitate, or incidental or conducive to, the carrying out of its functions	When defining and implementing its strategy, reg arm must act reasonably, and in particular must have regard to the statutory requirements of section 28 (compliance with reg objectives and principles of better regulation)
		What is or is not a regulatory function is determined in accordance with the Act. Subject to the Act, whether something is 'regulatory' should ultimately be for the reg arm to determine, in close consultation with the residual AR.
	Access to resources • AR must provide reasonable resources so as to allow reg arm to implement and pursue the strategy it (the reg arm) has adopted	The checks and balances inherent should ensure value for money: the reg arm sets a strategy independently of AR; while the AR determines (albeit on an objective basis) reasonable resource requirements to meet that need
	Control over resources • reg arm must be free to spend money allocated to it as it determines appropriate, in accordance with its responsibilities under the Act	ARs should adopt an economic and efficient shared-services model, designed demonstrably to meet the need of the AR and its reg arm.
		Adoption of this model must not

the reality or perception of 'control' or 'undue influence'	and its delegation under these rules • if resources provided include corporate shared services (staff, facilities, accommodation, and/or data), reg arm must be genuine partner in overseeing the provision of such services.	impair independence or effectiveness of the reg arm "Genuine partner" should mean that: • reg arm needs are not subordinate to residual AR; • issues and disputes must be resolved fairly and in a way that demonstrates equality of arms and so independence
	Governance Reg arms should have freedom to determine processes and procedures necessary to discharge functions; and powers to communicate with whomsoever it wants, in whatever manner it wants, including whistle-blowing protections	In particular, media and stakeholder relations functions should come wholly under the control of the reg arm, with the case for opting out of 'shared' arrangements stronger because of the impact on independence and perception of independence

***Objective of breakout group 2*: Consider and comment on these suggested proposals. Additional *questions* to consider include: (a) the test and trigger for reg arms to 'walk away' from shared services models where they and the LSB agree that independence and/or effective are impaired; and (b) whether additional protections on financial resourcing should be included within the section 51 mechanism?**

(iii) The mechanics of independence rules – *Breakout Group 3*

This section deals with the **implementation** of rules to be made. There are three issues here. First, how and when should the LSB seek to approve arrangements which ARs are going to be required to make in accordance with the Internal Governance Rules? Linked to the approval process, the operation of periodic reassessment mechanism needs to be considered. Third, what will the process under section 51 look like, and in particular what criteria should the LSB use to judge applications against?

We would like to focus on each, testing the further thinking we have done since close of consultations.

Approval timetable

Clearly we need to achieve a balance. Once principles are settled and rules are made, they cannot be ignored. But too robust a timetable could divert attention away from the important job of regulation for little additional benefit. There also has to be a balance between consistency across the sector and recognition of the specific circumstances of each AR.

On or before 31 March 2010, we propose to require ARs to submit and publish proposed governance arrangements, compliant with IRG requirements, for LSB approval, together with:

(a) evidence to demonstrate compliance with those arrangements; or

(b) a published implementation plan (also to be agreed by the LSB) explaining when the AR is likely to bring itself fully into line with those arrangements, and suggesting suitable review points where the LSB should monitor progress with the plan.

To encourage close co-operation between ARs and their regulatory arms, we will expect regulatory arms, where already in existence, to certify their agreement to the AR's application, or to provide detailed representations on why they feel unable to so certify.

If an implementation plan is required, we will expect the AR to base its proposed timeline on an analysis of the risks associated with non-compliance. Where practicable, we would also encourage a range of interested parties to be consulted on the identity and scale of those risks. For example, any associated consumer and practitioner panel(s) would presumably be well-placed to comment on analysis before submission to the LSB. Naturally, where the risk (e.g. to regulatory objectives, to principles enunciated by the LSB, or to the effectiveness of the regulatory arm's performance) is significant, the LSB will expect a short implementation timetable. Where risks are less great, the LSB may be willing to accept a more lenient timeframe.

Dual Self-Certification

The LSB proposed a dual self-certification model in its consultation paper. The vast majority of submissions seem supportive of the proposal, on grounds of proportionality and effectiveness. However, a small number of respondents suggested it was neither necessary nor appropriate to include the 'dual' element. As the AR is responsible, it should self-certify; and if the regulatory arm was dissatisfied, it could approach the LSB in any event.

We remain attracted to the model proposed in the consultation paper. Indeed, the absence of a pro-active duty on respective parts of the AR to report publicly would mean significantly more scrutiny by the LSB to assure itself that s30 rules were being met. Therefore the dual duty is considered to be the most proportionate way of proceeding. Subject to further analysis, we also consider the 'dual' involvement of AR and regulatory arm to be beneficial:

- for ARs in focusing minds – particularly where there was a requirement to publish certificates and accompanying evidence;
- for us in understanding how well the rules we make ensure that our overriding principles are met;

We propose a requirement on ARs to complete a questionnaire, which will ask ARs and (separately, using an identical questionnaire) regulatory arms:

- to confirm that the principles established by the LSB, possibly to be set out as recitals to the rules themselves, are met – and to annex evidence to demonstrate how they are met and how any issues have been resolved;

- to confirm arrangements are in place meet each of the requirements of the Internal Governance Rules – and to annex evidence to explain how any issues have been resolved; and
- where it has not been possible for either or both parties to certify compliance with principles or rules, to submit a plan (with an explanation in the event of any disagreement) as to how and when certification will be possible.

There may also be a requirement/option for a Board-to-Board style meeting, either as part of a wider review process or otherwise.

Section 51 – process and criteria

Our work on section 51 rules is based on the assumption that rules to be made under section 30 work, i.e.:

- the Internal Governance Rules (IRGs) are robust, the arrangements made under those rules by each AR are approved and the dual self-certification model assures the LSB that the risks which IRGs are designed to avoid are indeed avoided; and therefore
- the arrangements made by each AR to develop and settle its section 51 applications will already have passed the regulatory independence tests/periodic reviews.

On that basis, particularly where checks and balances exists between representative-led ARs and regulatory arms, we also assume that, on the face of it, the proposed practise fee (PF) will be neither too high (acting as a barrier to market entry, with negative impacts on e.g. diversity and competition) nor too low (endangering the ability to discharge regulatory responsibilities and the longer-term viability of the AR). Where that check and balance does not exist, we will look for possible alternative ways to assure ourselves on these fronts.

In terms of the consultation proposals, submissions supported the general stance regarding the use of memoranda of understanding in respect of the approval of each respective practise fee application. We propose memoranda of understanding should include:

- agreed timetables that define decision points and provide for close LSB engagement throughout the process prior to final submission;
- the criteria against which decisions will be made; and
- the evidence to be submitted, which will include any requirement for consultation.

Timetables will generally be tailored to each individual AR, and we propose linking those timetables (at least in part) with the dual self-certification timetables thus ensuring that regulatory arm resourcing is considered at a relevant point in the budgeting cycle.

Provisions on **criteria** and **evidence** are likely to be consistent across the sector. In summary, and subject to a de minimus test whereby some formality could be foregone if the proposed year-on-year change was very small, the LSB proposes:

Principles – in suggesting its guidelines/rules, the LSB will be seeking to ensure that

- the proposed PF is transparent to authorised persons paying the fee;

- PF income is only to be applied for permitted purposes; and
- ARs have budgeted to cover exceptional regulatory needs as and where required, over and above anticipated/planned expenditure

Criteria – ARs' applications will be judged against the following criteria

- evidence demonstrates that reasonable care was taken in settling the application, in particular in relation to budget collection and likely impacts on the profession;
- evidence demonstrates that PF funds will be applied only for permitted purposes;
- elements of the PF to be allocated to mandatory regulatory permitted purposes (which are the responsibility of regulatory arms, where required) are explicitly identified; and
- authorised persons paying the fee will be told how the money they pay is to be applied between regulatory functions and any other functions.

Evidence – ARs should submit and publish the following under cover of an application

- a description of how the application was developed and settled, including any consultation carried out;
- a budget showing anticipated PF/entity income, all other expected income to be applied to permitted purposes and planned expenditure of PF income against the permitted purposes;
- an explanation of how the cost to each regulated person is to be broken down as between income to be allocated to the discharge of regulatory functions and income allocated to any other functions;
- an explanation of contingency arrangements where unexpected regulatory needs arises in-year;
- evidence of how the previous year's PF/entity income was allocated only to permitted purposes; and
- a regulatory and diversity impact assessment.

***Objective of breakout group 3*: To consider and comment on suggested proposals. Particular questions to consider include: (a) could all ARs meet a 31 March deadline for section 30 arrangements and which risks should LSB pay particular attention to when agreeing implementation timetables; and (b) should the LSB make Practice Fee rules or guidance, supplementing section 30 rules, encouraging/requiring reg arms to have lead role in section 51 applications?**

Legal Services Board

July 2009