LEGAL SERVICES BOARD

# Internal Governance and Practising Fee Rules

*Response to Consultation*

**December 2009**

# Contents

# Executive summary

This document is about how to embed and protect the integrity of regulatory independence. It sets out the rules that the Legal Services Board (LSB) has made to do this.

The basic policy ideas behind those rules have roots that stretch back almost a decade. The ideas formed the building blocks of the Clementi Review in 2004. More importantly, they shaped the legislation by which the entire legal services regulatory framework is now governed: the Legal Services Act 2007 (the Act). Over the last year, we have engaged with approved regulators, consumer organisations and others to translate high-level policy into practical and proportionate rules.

The agenda to separate the business of regulation from the business of representation is, therefore, nothing new. Indeed, most of the approved regulators we now oversee have put in place arrangements which seek to comply with the spirit of the Act.

Until now, those approved regulators have only been able to operate under that 'spirit'. The detail necessary to give certainty was to be left to our rules. We are now making those rules. The Internal Governance Rules (IGRs) and the Practising Fee Rules (PFRs) made by the Board are set out in Chapter 7 of this document. All involved in the regulatory framework can, therefore, focus on completing the important task in hand.

In this Response to Consultation, we explain where, how and why we have changed the draft rules published back in September. In most areas, the principles and rules we proposed have not been altered in any material respect. In some areas, however, we have made changes. And in others, we have clarified our illustrative guidance so as to explain how we envisage the principles and rules we have made might best be implemented.

In terms of the key decisions taken:

- **the LSB has varied the definition of 'Applicable Approved Regulator' (AAR) so as to clarify the position of regulators principally supervised by oversight regulators in other professional sectors**. Importantly, the approved regulators affected by the change will still be required to meet the general duty imposed by the IGRs, which is set out in Rules 6 and 7. However, the application of the Schedule to the IGRs will not be automatic. It will be for the LSB and each affected approved regulator to agree what arrangements must be made, in particular so as to ensure compliance with the general duty (see paragraph 4.6 in Chapter 4);

- **the LSB has retained its policy requirement for lay majorities for regulatory boards** and the finalised IGRs reflect that policy line (see paragraph 4.21);

- **the LSB has decided that the term 'lay person' should continue to be defined by reference to the template provided by the Act**. Importantly, all concerned (including consumers and the public more widely) should understand absolutely what is meant by the term (see paragraph 4.31 and 435);

- **insofar as regulatory board-level remuneration is concerned, the IGR's guidance has been clarified to highlight the principle of separation**. There are likely to be various models from which AARs can choose. Short of establishing genuinely independent corporate boards, however, the LSB can envisage few instances where anything short of constitutional delegation to the regulatory body would suffice – even if in practice the end result is a shared remuneration committee mechanism (see paragraph 4.50);

- **the IGRs continue to require approved regulators to approach the LSB if they wish to dismiss a member of the regulatory board**, although we have sought to clarify the accompanying illustrative guidance (see paragraph 4.53);

- **the LSB has revised its illustrative guidance in respect of line management and control of staff** (see paragraph 4.58);

- in relation to strategy and resource management generally, **the LSB has clarified its illustrative guidance so as to highlight the objective of genuine separation.** In addition, the over-arching principle now **clarifies that strategy and resource management can never be wholly divorced from the mechanisms for AAR oversight of their respective regulatory bodies** (see paragraph 4.64 and 4.65);

- **guidance has been updated to clarify that due regard should be had to internal dispute resolution mechanisms, in place under the IGRs, before a regulatory body seeks to vary arrangements for shared services** (see paragraph 4.68);

- **the LSB has amended the drafting of the 'oversight' principle**, which deals with the way in which approved regulators oversee their regulatory bodies, to reflect the complexities inherent in the 'separation' model. But in making this clarification, it must be clear that the over-riding spirit of the principle should not be seen as in any way watered down (see paragraph 4.72);

- **the PFRs include an amended definition of 'applicable persons' which extends to all those over whom approved regulators have regulatory reach** (see paragraph 4.76);

- **no change is considered necessary to widen the permitted purposes in respect of costs associated with or incidental to regulation etc**. Because of the sensitivities involved, however, the LSB has made some remarks insofar as the management of pensions are concerned (see paragraph 4.81);

- **the permitted purposes have been extended in respect of the payment of financial penalties** (see paragraph 4.83); and

- **an 'access to justice' permitted purpose will not be included in the PFRs** (see paragraph 4.87).

The making of these rules marks a significant juncture in a long and constructive process of engagement and consultation. After informal meetings in late 2008, we launched a formal consultation on provisional policy proposals in March 2009. We then conducted a

supplementary consultation in September. Those combined consultations have run for a total of over 19 weeks. Outside those formal consultation periods, we have hosted 3 workshop seminars for key stakeholders and held over 30 one-to-one stakeholder meetings.

We want again to thank all stakeholders for working with us during the development process. We think that the finalised rules provide a sound basis for moving forward. In particular, we look forward to putting discussions of constitutional governance to one side so that we can all begin to focus on the hard substance of regulation against the regulatory objectives set out in the Act.

**Legal Services Board**

December 2009

# 1. Introduction

1.1. This document is the post-consultation report for the supplementary consultation paper, *Internal Governance and Practising Fee Rules*[1]. That paper, which followed the earlier consultation, *Regulatory Independence*[2], sought representations under section 205(3) of the Legal Services Act 2007 (the Act) on two sets of draft rules which must be made under the Act. The supplementary consultation paper was published alongside a Response[3] to the earlier consultation.

1.2. All submissions received by the Legal Services Board (LSB) in respect of the supplementary consultation paper have been published online[4]. A list of respondents is included at ***Annex A*** at the rear of this report.

1.3. This report will cover:

- the **background** to the consultation paper (Chapter 2);
- an **overview** of consultation responses (Chapter 3);
- an **analysis of the key issues** arising from representations received (Chapter 4);
- a **summary of specific representations** made in consultation submissions (Chapter 5);
- the conclusions reached by the LSB concerning **implementation** of the rules (Chapter 6); and
- the finalised **rules** made under sections 30(1) and 51(3) and (6) (Chapter 7).

1.4. This report, therefore, gives details of material changes between the earlier draft rules consulted upon and the rules now made, in accordance with section 205(5) of the Act.

1.5. In addition to the list of respondents included at ***Annex A***, also annexed to this document are:

- ***Annex B*** – an updated impact assessment; and

[1] See: http://tinyurl.com/ygr3qpq
[2] See: http://tinyurl.com/yf6ycm3
[3] See: http://tinyurl.com/yjymwe3
[4] See: http://tinyurl.com/yhqbtqe

- ***Annex C*** – the template certificate that has been designed for the dual self-certification process, to be introduced under the Internal Governance Rules.

1.6. If you would like to comment on the consultation process undertaken, or to request a hard (or alternative electronic) copy of this report, please contact:

**Email**: consultations@legalservicesboard.org.uk

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Southampton Row
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# 2. Background

2.1. The LSB published a consultation paper, *Regulatory Independence*, on 25 March 2009. That paper sought views on policy proposals in respect of draft rules that were required to be made under sections 30 and 51 of the Act. The LSB published its Response to that consultation on 16 September.

2.2. Alongside the Response to Consultation, which announced the LSB's position in respect of several key policy issues, the LSB also published a supplementary consultation paper, *Internal Governance and Practising Fee Rules*. That supplementary paper included draft Internal Governance Rules (IGR) and draft Practising Fee Rules (PFR), which the LSB proposed to make under sections 30 and 51 of the Act respectively.

2.3. Under section 205 of the Act, representations were sought on those proposed draft rules. Representations were invited by 30 October.

## The proposals

2.4. The supplementary consultation paper set out, in its Annex, the two sets of draft rules on which representations were invited. It also, in its Chapter 3, summarised the significant changes between the annexed draft rules and the earlier policy proposals set out for consultation in March.

2.5. The significant changes identified in Chapter 3 of the supplementary consultation paper were:

- **the structure of the rules** – the rules proposed in the supplementary consultation had been structured in the form and manner developed for all statutory rules to be made by the LSB;

- **application of the rules** – while the more detailed principles, rules and guidance set out in the Schedule to the IGRs were designed to apply to 'Applicable Approved Regulators' (i.e. those approved regulators responsible for representative as well as regulatory functions), to reflect the requirements of the Act, *all* approved regulators would become subject to the general duties set out in the IGRs;

- **definitions** – key concepts introduced to the proposed IGRs published in September included 'the principle of regulatory independence', 'prejudice' and 'undue influence', all of which were defined at the start of the IGRs;

- **composition of regulatory boards** – while the LSB announced that it was minded to retain its policy position in respect of composition generally (e.g. in respect of the requirement for lay majorities on

regulatory boards), it did propose to modify proposals in one specific respect. That concerned the practical management and control of the process to recruit and appoint/re-appoint members of regulatory boards. The revised proposal would see a slightly more flexible approach, although the requirement for appropriate independence would remain;

- **provision of shared services** – the revised IGRs sought to give greater flexibility to approved regulators to manage the provision of commonly-sourced corporate services, like accommodation, HR, IT and finance functions; and

- **permitted purposes** – in order to ensure that approved regulators had scope to apply funds raised through practising fees to the regulation of all those over whom they had regulatory reach, the drafting of the 'permitted purposes' was amended. The result of the amendment was the introduction of a new category of 'applicable persons', a term that included lawyers who had paid their practising fees but also to others within the regulatory scope of the approved regulator.

## The process

2.6. The supplementary consultation paper, deliberately, posed no specific questions on issues of policy detail. The earlier consultation had focused on relevant policy issues and the LSB responded in light of the submissions received. Instead, the supplementary consultation paper invited representations on the proposed rules, which were set out in the paper's Annex.

2.7. As paragraph 3.28 of the supplementary consultation paper made clear, in inviting representations on the proposed rules, the LSB was in particular keen for consultees to comment on the extent to which the revised rules complemented the policy positions announced in the accompanying Response document. The policy issues summarised above at paragraph 2.5. were the key focus.

2.8. During the consultation process, some of the approved regulators met individually with the LSB to discuss particular issues arising. After the close of the formal consultation period, the LSB hosted two informal stakeholder meetings:

- the first with approved regulators which would be 'Applicable Approved Regulators' (AARs) under the proposed IGRs, to consider implementation issues including the timetable which AARs should meet and the process for dual self-certification; and

- the second with bodies that are expected to become approved regulators after 1 January 2010, with the focus on how the IGRs and PFRs could be applied proportionately to 'new entrants' whilst retaining the essential characteristics of robust and demonstrably independent regulation.

2.9. All such meetings, in addition to the representations made through formal consultation, have been very helpful in developing the LSB package of proposals in respect of the rules which must now be made.

2.10. The LSB would again like to take the opportunity to thank all those individuals and organisations that have engaged throughout the policy development process. Stakeholders have been constructive and helpful – and the LSB looks forward to continuing to work with them during the implementation period and beyond.

# 3. Overview of consultation submissions

3.1. The supplementary consultation on Internal Governance and Practising Fee Rules ran between 16 September and 30 October 2009. It was a statutory consultation, under section 205(3) of the Act. The main focus therefore was specifically on the draft rules which the LSB proposed to make, rather than the underlying policy that had been consulted upon previously.

3.2. In all, 18 individuals and organisations submitted responses. Of those 18, there were:

- 7 approved regulators (only the Association of Law Costs Draftsmen (ALCD) did not submit a response, although its officers have engaged with the LSB separately);
- 3 regulatory arms (the Solicitors Regulation Authority (SRA), Bar Standards Board (BSB) and Intellectual Property Board (IPREG), with ILEX Professional Standards (IPS) submitting a joint response with the Institute of Legal Executives (ILEX));
- 2 accountancy regulators scheduled to become approved regulators in 2010;
- 2 individuals (both solicitors and both having also responded to the first regulatory independence consultation); and
- 4 others (including the Consumer Panel Chair, a local law society, a pro bono organisation and a public authority).

3.3. Each of the 18 respondents is set out at **Annex A** to this paper. The submissions themselves are available on the LSB's website[5].

## Headline messages

3.4. There were few, if any, substantively new issues raised. Overall:

- most respondents supported the proposed broad framework for the IGRs and in particular the use of over-riding principles, rules where judged necessary and illustrative guidance supporting the mandatory principles and rules;
- no respondent disagreed with the flexible and high-level approach adopted in respect of Practising Fee approval. However, approved regulators indicated a keenness to start working bilaterally with the LSB soon in respect of the forthcoming 2011 applications;

[5] See above, footnote 4.

- the two prospective approved regulators from outside the legal services sector were concerned about the proportionality of internal governance requirements designed (as they saw it) primarily for the regulators responsible wholly or mainly for the regulation of lawyers;

- there was a united call from approved regulators for the LSB to take a reasonable and proportionate line with respect to implementation timetables; and

- there remain some issues of detail, in respect of both sets of rules, where certain stakeholders (sometimes with a strong majority view) disagree with the adopted policy of the LSB. In certain instances, it has been suggested that the LSB is proposing to over-step the ambit of its powers.

3.5. In the following chapter, key issues arising are analysed. Chapter 5 goes on to summarise the submissions received in response to the supplementary consultation exercise.

# 4. Key issues arising from submissions

4.1. Issues arising from the consultation can broadly be categorised under three headings:

- issues about the LSB's approach to regulatory independence generally;
- issues in relation to the proposed IGRs; and
- issues in relation to the proposed PFRs.

## General

4.2. The first category of issues raised by submissions is summarised from paragraphs 5.16 to 5.18 of Chapter 5. The basic point made here is that significant compliance burdens would be disproportionate for regulators that may be new insofar as designation under the Act framework is concerned, but which are wholly or mainly established regulators in other professional sectors (e.g. those covering accountants, surveyors, architects, or financial services) under the oversight of existing and competent oversight regulators.

4.3. The concern relates in particular to the application of the IGR's scheduled principles, rules and guidance, which were argued to be potentially disproportionate, in particular where other oversight regulators share responsibility for governance issues. The IGR's Schedule, under the draft rules proposed in the supplementary consultation paper, applied solely to AARs. AARs are those approved regulators that are responsible for both regulatory and representative functions.

4.4. Having had regard to the representations made, both through the supplementary and original consultations, the LSB accepts that there is a point to be met. In respect of certain bodies – if and only insofar as certain key criteria are met – categorisation as an AAR may be disproportionate. Ultimately, of course, where such bodies are designated as approved regulators, they will have to meet the requirements of the Act. Moreover, they will need to meet standards set by the LSB. However, the LSB recognises:

- the need to allow, if and where required, additional flexibility where the scheme of the IGRs might conflict with, contradict or make much less practicable a new approved regulator's adherence to other oversight regulations when those other oversight regulations relate to the principal regulated activities of that new approved regulator;
- that the new approved regulators likely to fall into this category from early 2010 (exclusively from the accountancy sector at this stage) will have responsibility only for a very narrow range of reserved legal services (i.e. probate services); and

- at least at this stage, the new approved regulators will have very few authorised persons regulated by them – i.e. there will be very few accountants that also have authorisation from an accountancy sector approved regulator to perform probate services.

4.5. In that light, the LSB believes that proportionality requires a degree of flexibility in application of the Schedule of the IGRs. In particular, such flexibility is required to ensure that the LSB can best further the regulatory objectives and the principles of better regulation.

4.6. Accordingly, **the LSB has varied the definition of 'Applicable Approved Regulator' so as to clarify the position of regulators principally supervised by oversight regulators in other professional sectors**. Importantly, the approved regulators affected by the change will still be required to meet the general duty imposed by the IGRs, which is set out in Rules 6 and 7. However, the application of the Schedule to the IGRs will not be automatic. It will be for the LSB and each affected approved regulator to agree what arrangements must be made, in particular so as to ensure compliance with the general duty.

4.7. As this amendment is made principally on grounds of proportionality, the larger the regulator, the more authorised persons it regulates, the more reserved legal activities it oversees and the longer it has been operating as an approved regulator will be among the factors which the LSB will need to take into account when considering what arrangements would be appropriate in the given circumstances. In any event, the LSB will consider the operation of this specific definition when it first reviews the IGRs.

4.8. It is important to highlight that the LSB does not consider this amendment to give any consequential (e.g. competitive) advantage to new approved regulators over any existing approved regulators. On the contrary, because of the new bodies' exposure to other oversight regulation, this change is being made to avoid a competitive disadvantage to them. However, greater flexibility does not mean no regulation. The spirit of the Act and of the IGRs must still be met, whether an approved regulator is categorised as an AAR or not.

## Internal Governance Rules

4.9. The second category of issues raised by respondents gave rise to the majority of representations made. The key issues are explored below.

*Lay majorities*

4.10. As the summary in Chapter 5 shows (see paragraphs 5.29 to 5.34), the decision announced in September on the requirement for lay majorities on regulatory boards remains contentious. However, in assessing the representations made, it is important to keep in mind that the nature of the supplementary consultation was technical and focused on detail. The subject matter explored meant that the body of

respondents was both smaller and narrower than was the case in respect of the earlier consultation exercise. In that earlier process, a broad church of respondents agreed with the proposed lay majority approach.

4.11. No representations made during the course of the supplementary consultation have appeared to the Board to justify changing its policy decision. However, certain submissions did seek a clearer explanation of the policy and legal grounds on which the LSB is basing its decision. While the Response to Consultation published in September covered the issue in some depth, the LSB would like to take the opportunity to clarify why this is such an important issue.

4.12. In terms of the underlying rationale, the original 'separation agenda', focused on by the Clementi Review[6] and everything that has followed it, identified the need for appropriate assurances that regulation was not driven by the interests of the profession. Many consumer organisations and commissioning bodies have raised particular concerns about the need "to dispel the perception that the regulatory system is 'run by lawyers, for lawyers'"[7].

4.13. The involvement of non-lawyers was a critical part of that separation agenda. In particular, lay people serving on the boards of the LSB, Office for Legal Complaints (OLC) and regulatory arms of approved regulators were recognised by almost all as integral. Indeed, certain organisations lobbied Parliament to prescribe a requirement for lay majorities on regulatory boards[8].

4.14. Several reasons were articulated for seeking such a provision. For example, it was said that when making regulatory decisions, if there was a conflict between professional and consumer interests, consumers could not be confident that approved regulators would necessarily act objectively and in the public interest if regulated persons were in the majority. Further, the independent mindset brought by non-lawyers would help to broaden the experience and expertise of regulatory boards, helping to improve the decision-making process overall. For reasons such as these, the Bill would require the LSB to have a lay majority, so it was said to be inconsistent not to require the same arrangements for approved regulators.

4.15. In the end, section 30 of the Act did not include any such explicit requirement. It was not felt that this kind of prescriptive detail was appropriate for the face of the statute. However, the minister made clear that "once the [LSB] is established, it will need to set out more detailed criteria for the separation of regulatory and

[6] *Review of the Regulatory Framework for Legal Services in England and Wales* – Final Report (December 2004), Sir David Clementi: http://www.legal-services-review.org.uk/content/report/report-chap.pdf.
[7] *Legal Services Commission*, paragraph 17 of response to an SRA consultation on the Legal Services Act: http://www.legalservices.gov.uk/docs/consultations/8_SRA_Consultation_Paper_16.pdf
[8] See, for example, page 3 of the *National Consumer Council* Parliamentary briefing for Commons 2nd Reading of the Legal Services Bill: http://collections.europarchive.org/tna/20080804145057/http://www.ncc.org.uk/nccpdf/poldocs/NCC158a_br_legal_services_bill.pdf

representative functions of approved regulators"[9]. That end was to be achieved by making rules on the internal governance structures within approved regulators: the Internal Governance Rules.

4.16. Clearly, the IGRs need to be flexible. And the detailed rules introduced by the LSB can allow that flexibility far more easily than any provision on the face of an Act. One way in which the LSB has built in appropriate flexibility is by the introduction of its concept of 'Applicable Approved Regulators'. But the "detailed criteria" referred to by the minister are also required.

4.17. Having looked at other statutory rules dealing with independent governance issues, the LSB has found that it is quite usual for stipulations to be made about board composition. The requirement for lay membership of boards is a particular mechanism used to safeguard against the risk of regulatory capture.

4.18. The example quoted in September's Response to Consultation[10] was that of the General Medical Council (GMC). Schedule 1 of the Medical Act 1983 (as amended) provides that, among other things, the GMC is to have both 'registrant members' and 'lay members'. The underlying secondary legislation, the GMC's Constitution Order[11], goes on to provide that the registrant and lay members must be appointed in equal proportion. So the legislative scheme applying to the GMC mandates the appointment of lay members and a specific (and substantial) quantity of such members.

4.19. Other professional bodies are similarly constituted. In England and Wales, the General Optical Council is an example. In other jurisdictions, the Law Societies of Canada are constituted by a certain proportion of both legally-qualified and lay directors, or 'Benchers'.

4.20. More centrally, however, the Act itself requires the LSB and OLC to have a proportion of lay members. The Act's template is for lay majorities. The LSB announced in September that it was not persuaded that it should depart from this template, among other things because of the arguments advanced by consumer organisations during the passage of the Bill. For the following reasons, the LSB remains unpersuaded of any case for change:

- section 30 of the Act requires the LSB to make rules dealing with internal governance;

- it is clear that the LSB has scope to make provisions in its rules other than those which are set out (or dealt with) on the face of the legislation (otherwise there would be no need for any power, let alone any *requirement* to make rules);

[9] Bridget Prentice MP, speaking during the Commons' Public Bill Committee debate on 19 June 2007 (see column 225): http://www.publications.parliament.uk/pa/cm200607/cmpublic/legal/070619/pm/70619s02.htm

[10] See Regulatory Independence, Response to Consultation, paragraph 4.29 and footnote 16. See above footnote 3.

[11] SI 2008/2554

- the involvement of independent members is important to demonstrate that regulatory boards do not become – nor should they reasonably be perceived to become – unduly dominated by professional concerns;

- the involvement of lay members would also demonstrate that regulatory boards are not likely to be unduly sympathetic to the profession being regulated. Instead, the public should have confidence in the fact that a robust, fair and independent regulatory framework is in place;

- because lay involvement can be so closely linked to such separation and independence issues (e.g. the avoidance of regulatory capture), the case for lay involvement must reasonably be expected to fall within the band of issues that the LSB could reasonably consider to be part of the IGRs framework;

- accordingly, it must fall to the LSB, having made the judgment that lay involvement is essential (on the basis of the above analysis), to determine what specific provision should be made about such lay involvement;

- having looked at what constitutes good practice in other jurisdictions, and other professional sectors in this jurisdiction, options open to the LSB would include requiring a significant proportion of lay members, parity of lay and professional members and a lay majority; and

- having regard to the principle that the public must have confidence in the new regulatory framework, and in particular that the public must have confidence in the independence of that framework, a lay majority requirement is the most appropriate way to demonstrate the necessary integrity and independence.

4.21. Accordingly, **the LSB has retained its policy requirement for lay majorities for regulatory boards** and the finalised IGRs reflect that policy line.

*Definition of 'lay'*

4.22. Alongside the 'lay majority' issue, several respondents raised the LSB's proposed definition of 'lay'. Indeed, on a practical level, this was perhaps more of an issue than the lay majority rule itself. A summary of responses on this point is set out in Chapter 5 from paragraphs 5.6 to 5.11.

4.23. In the March-June consultation, the LSB did not explicitly define the term 'lay person'. However it did adopt that terminology, the meaning of which was fixed in precise and consistent terms by the Act, at least insofar as members of the LSB (and indeed the OLC) were concerned.

4.24. The LSB hosted an informal stakeholder workshop in July to discuss development of the policy proposals after the original consultation had closed. At that event, there was a consensus that the IGRs should include a definition, although there was no settled view among stakeholders about what that definition should be. One of a range of options explored was the Act's definition (i.e. that covering persons serving on the LSB and OLC Boards).

4.25. Later, in the LSB's supplementary consultation paper, it was explicitly proposed that the Act's definition should be adopted. In so consulting, the LSB decided that there was no reason strong enough to justify departing from the Act's clear template.

4.26. A number of points arise from consultation submissions. First, issues were raised in the specific context of the barrister profession. Because a barrister becomes a barrister after completing the necessary academic and vocational training, it is not necessarily the case that 'a barrister' will ever have worked (or even intended to work) as a lawyer.

4.27. Compare the position of barristers, however, with solicitors. A person training to become a solicitor can go and do their law degree, go through law school for a year and complete almost all of a two-year training contract (i.e. working in a law firm), but still not become a solicitor. If the person leaves the training contract having failed by, say, a month to reach the two-year qualifying period, s/he gains no right to use the title 'solicitor', is not recognised as an authorised person, and so remains 'lay' for the purposes of the current definition. Compare also the position of a paralegal or practice manager who spends his/her entire career working within a law firm, but who would continue to qualify as 'lay' for the purposes of the Act's definition.

4.28. It might be considered anomalous that a person who has worked in a law firm for any duration is more likely to have a different mindset to that of a student who gained a professional qualification in the law, but then chose to work in entirely unrelated sectors for the duration of their career. Indeed, it is perhaps difficult to distinguish the Bar Vocational Course graduate from any other law degree graduate. And it would seem disproportionate to exclude graduates from the lay person category.

4.29. A further issue also arises in the context of the new professional bodies preparing to enter the legal services sector as approved regulators. To use the example of the accountancy bodies, unless an accountant has separately qualified as a probate practitioner (and so also becomes an authorised person under the Act), s/he will be a lay person for the purposes of the presently drafted IGRs. Assuming a requirement for lay involvement on regulatory boards was to apply to such bodies, a board of an accountancy regulator could end up with (for example) five accountants qualified as probate practitioners and six accountants with no additional qualifications, and still comply with the strict letter of the lay majority rule. That is unlikely to respect the spirit of the IGRs, or the Act.

4.30. However, the LSB considers that the balance of the argument remains in favour of retaining the Act's definition:

- first, the argument advanced by some approved regulators in response to the LSB's draft PFRs is instructive. While, for example, some barristers may qualify but never practise (or even ever intend to practise), the Bar Council/BSB still has regulatory reach over them. If you are subject to regulatory powers, it is difficult to argue that you are 'lay' in the commonly understood sense;

- second, the alternative approach put to the LSB through consultation responses (namely the setting of a certain time period of non-practise after which a once-qualified lawyer would be deemed as 'lay') would be rather arbitrary in its operation. The precise duration of any such period would be difficult or impossible to determine on any objective basis;

- third, the 'not qualified and never has been' test is also used as a template for several other statutory and non-statutory frameworks, in this country and in others; and

- fourth, the clear and consistent definition, itself adopted by Parliament for the purposes of the LSB and OLC, will be widely understood and so help to reinforce the new framework's increased independence and objectivity. Importantly, it will also reinforce the perception of such. This will help to command public confidence from the earliest stage of the Act's implementation. It would also leave a very wide category of persons who would qualify as 'lay', so leaving a very substantial pool of talent from which approved regulators could recruit.

4.31. The present definition is both robust and simple. It is also consistent with the wider statutory framework. Accordingly, **the LSB has decided not to alter the definition**. The issues of practicability raised by approved regulators and regulatory arms throughout the consultation process will have to be judged on their merits and in accordance with (among other things) the principle of proportionality. It is expected that the LSB will therefore be able to mitigate any undue or disproportionate impacts which could result.

4.32. Separately, the Consumer Panel Chair, in her consultation response, suggested that the term 'lay person' should itself be altered because it is defined entirely by what it is not (i.e. not a lawyer) rather than what it is (e.g. expert and independent). The suggestion of the Panel Chair was that such persons should be called 'independent persons'.

4.33. Furthermore, it seems that 'lay' could be interpreted as under-selling the expertise of the individuals concerned. After all, the term can be used as a synonym for amateur, unqualified, untrained or unprofessional. With a requirement for appointment on merit, both lawyers and non-lawyers should be highly experienced and skilled. What is more, it will not be strictly necessary for either to be 'professionally qualified' in the business of *regulation* – and so all candidates (whether qualified as lawyers or not) would be 'lay' in respect of the actual posts they were applying for.

4.34. The term ‘lay’ might not therefore be ideal. However, ‘independent’ might not be an ideal alternative. Styling non-lawyers as independent persons could imply that the lawyer members are not (and/or should not be) bound by the same requirements in respect of objectivity and separation from representative roles. That impression would be entirely wrong.

4.35. The LSB understands and agrees with the Consumer Panel Chair’s analysis: the term ‘lay person’ is not ideal. But it does carry one distinct advantage. It is a term that is used by the Act to convey a strict and robust meaning. The LSB’s policy reflects that of the Act. Adopting the same terminology is a positive advantage, therefore, in terms of clarity and consistency. Accordingly, **the LSB has decided that the term ‘lay person’ should be retained** because all concerned (including consumers and the public more widely) should understand absolutely what is meant by the term.

*The status of residual approved regulators*

4.36. As an issue, the status of approved regulators as compared to their regulatory arms received less comment (in terms of quantity of responses) than issues like lay majorities and definition of lay. However, it is clear that, for some, and in particular for some approved regulators that will be categorised as AARs, this is a central issue.

4.37. The various issues are summarised in Chapter 5 between paragraphs 5.51 and 5.62. In brief, concerns remain with the LSB’s proposals in respect of the ultimate right of each approved regulator:

- to retain powers in respect of setting remuneration levels for members of regulatory boards;
- to discipline (including dismiss) members of regulatory boards, for example in cases of gross misconduct, without acquiring LSB consent;
- to ensure that delegated powers in relation to the line management of staff members do not expose the approved regulator to liabilities in respect of (for example) employment law and financial liabilities, especially in relation to pensions;
- to ensure that delegated powers in relation to resource allocation and strategy setting are not abused or exercised in a way that the approved regulator considers unacceptable;
- to prevent regulatory bodies from ‘unilaterally opting out’ of shared services agreements; and
- to ensure its regulatory responsibilities under the Act are being carried out to a sufficient standard by its regulatory arm, thus assuring itself that it is incurring no liabilities in its role as a designated approved regulator.

4.38. These issues are an inherent part of the Act's framework: approved regulators are ultimately responsible for the regulatory functions vested in them, but have a requirement to separate responsibilities within their organisational structures. Defining the extent to which separation is necessary and appropriate was never going to be clear-cut.

4.39. These various strands can all be pulled together very succinctly. The AARs say that: (a) they are the statutorily-designated approved regulators; (b) accordingly, they have a responsibility to ensure that delegated functions are carried out to a sufficient standard and at reasonable cost; and (c) if the regulatory arm ever fears that its independence or effectiveness is compromised or prejudiced, it has an automatic and unfettered right of access to the LSB. If the LSB is satisfied that the regulatory arm's case is valid, (d) the LSB can direct the approved regulator accordingly.

4.40. On that analysis, however, there would be no need for the LSB to make rules in the above bulleted areas. The end result would always be, wherever the LSB deemed it necessary, that enforcement action could be taken.

4.41. The alternative view is that the IGRs should identify those issues that constitute 'lines in the sand'. In so doing, it would seek to avoid the need for regulatory bodies to exercise their right of access 'after the event'. Prevention is always better than cure.

4.42. While the LSB could start with a less fulsome set of rules, and add more detail if and where actual problems are evidenced, setting out a clear set of principles at this early stage is considered most appropriate for the purpose of meeting the regulatory objectives.

4.43. The confidence of consumers and of the public in this new system of regulation is key. It is likely to increase if the LSB is clear from the very beginning about the standards it expects. Any alternative approach could lay the new regulatory framework open to the charge of 'rebadging', rather than introducing substantially new processes to achieve substantially different outcomes.

4.44. That is the context which shapes the LSB's analysis of the issues which follow.

*Remuneration of regulatory board members*

4.45. In respect of remuneration of board members (Chapter 5, paragraphs 5.41 to 5.42), the LSB was pointed in the direction of the Financial Reporting Council's (FRC's) Combined Code on Corporate Governance[12]. The argument against the LSB's original proposal was that the IGRs are out of step with the Code.

[12] Combined Code on Corporate Governance, FRC, June 2008: http://www.frc.org.uk/documents/pagemanager/frc/Combined_Code_June_2008/Combined%20Code%20Web%20Optimized%20June%202008(2).pdf

4.46. Irrespective of strict applicability[13], it is most unlikely that the LSB's original policy formulation conflicted with the provisions of the Combined Code. The principle here is that the pay of regulatory board members should not be controlled, in practice, by a body that is itself controlled by representative persons. There is a clear difference between saying the function of remuneration setting should be delegated (so allowing the regulatory board to deal with the issue in accordance with what would otherwise be best practice) and saying that regulatory board members should decide their own pay without having any regard to best practice.

4.47. That said, consultation responses did demonstrate a desire for greater clarity on this issue.

4.48. It is not the case that, in principle, the LSB wants to achieve delegation of remuneration setting powers to a regulatory board. Rather, the principle is that the power should be separated from representative fetter, or the perception of such. One way to achieve this would be to delegate, and then expect the regulatory board to exercise the power in accordance with best practice. One (although perhaps not the only) alternative approach might be for an approved regulator to establish a genuinely independent corporate board, separated from representative functions, and give oversight powers to that new board. This model could perhaps be modelled on that which Lord Hunt's well argued and recently published Legal Regulation Review recommended in respect of the Law Society[14].

4.49. In practice, whatever model an approved regulator adopted, if it meant that the approved regulator and its regulatory arm ended up sharing a joint remuneration committee, so avoiding the need to engage (and pay for) more independent members to comply with the Combined Code requirements, the LSB is unlikely to find problems with that arrangement. Indeed, establishing entirely separate committees at further cost where no, or no significant, benefit would result is most unlikely to comply with the core duties under the Act (e.g. in respect to the better regulation principles). Such duties apply equally to approved regulators and all parts of them (including regulatory bodies or corporate boards).

4.50. The LSB agrees that, **insofar as regulatory board-level remuneration is concerned, the IGR's guidance has been clarified to highlight the principle of separation**. There are likely to be various models from which AARs can choose. Short of establishing genuinely independent corporate boards, however, the LSB can envisage few instances where anything short of constitutional delegation to the regulatory body would suffice – even if in practice the end result is a shared remuneration committee mechanism.

[13] It is unlikely that the approved regulators will, strictly speaking, be bound by the Combined Code: none of them are listed on the London Stock Exchange. However, the Code is very likely to be understood as representing best practice. And each AAR, like the LSB, will be required to have regard to any principles appearing to it to represent best regulatory practice.

[14] *The Hunt Review of the Regulation of Legal Services*, October 2009. See recommendations 17-21 and pp 50-51: http://www.legalregulationreview.com/files/Legal%20Regulation%20Report%20FINAL.pdf

*AR powers to discipline and dismiss board members*

4.51. Approved regulators are worried about being exposed to liability and either not being able to act as they see fit in relation to that liability or acting as they see fit but then exposing themselves to regulatory action from the LSB. Representations from consultees are summarised in Chapter 5 from paragraphs 5.43 to 5.45.

4.52. Ultimately, if an approved regulator is exposed to liability, it must be able to act appropriately, having considered all the circumstances of the case. However, where so acting, it must balance any competing interests bearing on it, which in this context will include the duty to comply with the principle of regulatory independence.

4.53. The LSB believes that, among other things, the public interest is served by giving the public and consumers confidence that the regulatory regime is robust, yet proportionate. Accordingly, the LSB has decided that **the IGRs continue to require approved regulators to approach the LSB if they wish to dismiss a member of the regulatory board**.

4.54. In turn, the LSB must hold itself to the standards set out in the Act, including the principle that the Board's principal role is one of oversight. Therefore, the exercise of discretion in relation to judgment calls should be left to the approved regulators, so long as they remain within the band of reasonableness. However, it will be unreasonable (and so in breach of the IGRs and the Act) for an approved regulator to exercise its discretion without articulating how it has fulfilled its responsibilities in the context of the IGRs. If no or (in the opinion of the LSB) no sufficient articulation is made, the approved regulator can be taken to have acted unreasonably.

4.55. While it will keep the Rule bearing on this issue, **the LSB accepts that the accompanying illustrative guidance could be improved**. In particular, guidance should clarify that the LSB recognises that exceptional circumstances might justify departure from the Rule (i.e. the Rule that LSB concurrence is necessary). The approved regulator will run a risk in such circumstances, in that if it acts outside the IGRs it could expose itself to LSB action. So the approved regulator must be extremely careful in balancing its judgments appropriately. But in choosing to dismiss a member of an 'independent' regulatory board, one would expect the approved regulator to undertake that assessment in any event.

*Employment liability*

4.56. The stance of some of the AARs in respect of the responsibilities of approved regulators as employers – and in particular around the issues of determining terms and conditions for members of staff – is summarised at Chapter 5 from paragraphs 5.56 to 5.57. In essence, it is suggested that the LSB cannot expect to label employment liabilities as independence issues because, as employers, ultimately the Employment Tribunals and Courts (among others) will hold *them* to account, rather than the LSB or the ring-fenced regulatory boards.

4.57. At present, the specific provisions in respect of employment responsibilities (including on line management and terms and conditions) are set out in guidance.

That guidance is 'illustrative' and approved regulators could depart from it where judged necessary or otherwise appropriate. However, in so acting, no approved regulator could ignore the over-arching principles and rules set by the LSB.

4.58. Again, consultation responses demonstrate a desire for some further clarification. The LSB has therefore **the LSB has revised its illustrative guidance in respect of line management and control of staff**. However, that revision is in no way meant to alter the core principles set out in the IGRs. In the LSB's view, neither is there any good reason to so alter.

4.59. The following illustrative guidance is issued under Rule 11 of the Internal Governance Rules. Accordingly, approved regulators should have regard to the guidance when seeking to comply with the requirements of the Rules themselves.

**Illustrative guidance: employment responsibilities**

The position of applicable approved regulators, at least as presently constituted, as single employers is a fact. As a matter of law, they will have certain rights and responsibilities flowing from their status as such. Accordingly, it will be incumbent on them to ensure compliance with the law.

It is necessary to acknowledge that. However, it is also necessary to clarify how an appropriate balance might best be achieved in practice.

First, it would be sensible to explore what is meant by the rights and responsibilities of an employer in this regard. It is possible to break down such obligations into four heads:

- the duty to put in place a general statutory framework (including responsibilities for putting in place – and ensuring operational effectiveness of – policies in relation to occupiers liability, working time, health and safety, discrimination and the like);

- the duty to establish a management framework across the organisation (including responsibilities for arrangements concerning pay, holidays, sick leave etc);

- the responsibility for defining job descriptions and roles according to need (benchmarking pay scales and determining what work is done at which level); and

- the responsibility for performance and work management (overseeing the work of particular individuals, directing it and appraising it).

Ultimately, of course, as employer, the approved regulators will be responsible for *all* these functions. But that is ultimately. As a general proposition, and in the

context of regulatory independence, some functions will fall more naturally to the employer/approved regulator (normally after due – and genuine – consultation with the regulatory arm); some functions fall more naturally to the regulatory arm (normally after due – and genuine – consultation with the employer/approved regulator); and some functions will be rather more difficult to place.

The LSB considers that duties concerning general statutory responsibilities (i.e. the first bullet in the above list) would seem to fit best in the first category. So the presumption would be that the employer/approved regulator exercises the function, but not without genuine consultation. The penultimate pair of bullets, in respect of defining job descriptions and managing performance, would (insofar as 'regulatory staff' were concerned) seem to fit best in the second category. So the exercise would best be managed by the regulatory board, after due consultation. Again, this would be a presumption.

In respect of the second bullet (general management functions), approved regulators as employers must (ultimately) have the last word if a regulatory arm proposes something that carries significant unacceptable risk. However, in practice, the LSB believes that the responsibility should basically be shared. The presumption would be that the approved regulator will always agree a reasonable request from its regulatory body. While an approved regulator should have a right to veto, it should also understand that it carries a responsibility to justify that decision in light of the LSB's presumption.

Some particular issues might prove to be exceptions to the above general rule, and guidance should recognise flexibility where required. But the presumptions made in the general rules above should be displaced only by fully and publicly argued justification.

4.60. On the basis of the above illustrative guidance, and in practice, any unilateral action by a regulatory board without the concurrence of the employer/approved regulator would be unacceptable. It could expose the employer to liability and so safeguards should be in place to prevent that. But it would be equally unacceptable, in the context of the independence requirements, for any approved regulator to withhold concurrence in respect of a regulatory arm's proposals, unless the regulatory board was seeking to do something that would expose the approved regulator to undue liability or was otherwise unreasonable.

4.61. Similarly, it would be unacceptable for the approved regulator to impose upon the regulatory body something which (subject to any liability issues for the former) the latter would reasonably find unacceptable. The balancing act demanded by the Act's framework does not allow an approved regulator, regulatory arm, or the LSB to focus on the purely black and white. A reasonable path must always be trodden.

*Strategy and resource management generally*

4.62. Certain consultees made representations to the effect that it is of fundamental importance to recognise the approved regulator's over-arching role in respect of

strategy and resourcing. Such representations are summarised in Chapter 5 from paragraphs 5.51 to 5.55.

4.63. Again, the issue here is to ensure adequate separation from representative functions and interest. If arrangements can be put in place that satisfy the requirement for separation, then a greater degree of oversight is likely to be permitted. Without that separation, the LSB will act as a buffer against the representative Council.

4.64. In response to the representations made, **the LSB has clarified its illustrative guidance so as to highlight the objective of genuine separation**. As elsewhere, that separation is likely to be achievable in numerous ways. It will be for the AARs to adopt the model they find most appropriate for themselves.

4.65. The LSB will also modify the drafting of the principle in Part 3 of the table set out in the IGR's Schedule. Those slight amendments, while not bearing on the substance of the principle's spirit, **clarify that strategy and resource management can never be wholly divorced from the mechanisms for AAR oversight of their respective regulatory bodies**. However, such amendments should not be understood as doing any more than clarifying what was already thought to be clear. The LSB will robustly defend the ability of those charged with discharging regulatory functions to carry out their roles independent of any undue influence or control.

*Shared services opt-outs*

4.66. The issue about 'unilateral' decisions to 'walk away' from shared services is covered in Chapter 5 from paragraphs 5.61 to 5.62. The LSB is clear that the issue needs to be framed in terms of ensuring that regulatory arms have the tools to do their job and that AARs should provide such tools. The language of 'opt out' is not particularly helpful in such a context.

4.67. However, it may be that the currently framed guidance is guilty of stating the case too baldly. It is clear from the rules proposed that AARs have to have in place dispute resolution arrangements and so the point that such arrangements should be exhausted before any action is taken seems perfectly in line with original intentions.

4.68. The LSB believes its position to be clear insofar as the presently drafted IGRs are concerned. Subject to slight amendment to make clear that **due regard should be had to internal dispute resolution mechanisms, in place under the IGRs, before a regulatory body seeks to vary arrangements for shared services**, the LSB sees no persuasive reason to alter the principles, rules and guidance at this stage.

*Residual powers to hold ring-fenced bodies to account*

4.69. One consultee suggested that the principle in Part 4 of the Schedule to the IGRs, dealing with the AARs' oversight role, should make specific acknowledgement of the fact that the AAR is the legally-designated approved regulator and so ultimately

responsible for the discharge of functions, whether delegated or not. This point is summarised in Chapter 5 from paragraph 5.63 to 5.65.

4.70. Legally and factually, this is of course correct. Whether or not the position is stated in the rules, it will have effect under the rules and the wider law. However, the strict rule which prohibits AAR intervention in the management or performance of regulatory functions (unless with the concurrence of the LSB) remains. As do the other principles requiring independence to be respected.

4.71. Ultimately, this area – like all others – will be a balance. The LSB cannot, at least without evidence of systemic failure and widespread prejudice (which is most unlikely to arise), seek to introduce institutional separation by the back door. But no proposals made have suggested that the LSB wishes to do that. And the LSB has no desire to upend the new statutory framework in any event. All sides – LSB, AARs and regulatory bodies – must recognise the need for appropriate balance and strive reasonably to achieve that balance. The framing of the current rules seeks to achieve exactly that balance.

4.72. **The LSB has, therefore, amended the drafting of the 'oversight' principle**. But in making this clarification, it must be clear that the over-riding spirit of the principle should not be seen as in any way watered down.

## Practising Fees Rules

4.73. Proportionately far fewer substantive comments were made in respect of the PFRs. Owing to the higher-level nature of the proposed rules, and the need for the LSB to engage on a one-to-one basis with the approved regulators in terms of the lower-level details, this is perhaps not surprising.

4.74. The issues raised through consultation in respect of the proposed PFRs are summarised in Chapter 5 from paragraph 5.66. Over and above the various minor points made, two are worthy of focus in this Chapter.

*Applicable persons*

4.75. The first is summarised between paragraphs 5.68 to 5.75 of Chapter 5. It concerns the definition of 'applicable persons'. The crux of the point is that approved regulators need flexibility in the PFRs in order to apply monies raised through mandatory practising fees to the regulation of all those over whom they have regulatory reach. The provisions of the Act (section 51(4)) are not flexible enough, as they permit expenditure only in relation to, in effect, lawyers who have paid their practising fees. Non-practising barristers, for example, would not be caught – but the BSB/Bar Council still has regulatory reach over them.

4.76. Having worked with the approved regulators, the LSB is confident that the issue can be resolved satisfactorily. Accordingly, **the PFRs include an amended definition of 'applicable persons' which extends to all those over whom approved regulators have regulatory reach**. Indeed, this is consistent with the IGRs

treatment of 'lay persons' insofar as recognising persons over which approved regulators have regulatory reach as lawyers.

*Permitted purposes*

4.77. The second issue was summarised from paragraph 5.76 of Chapter 5. Respondents submitted that the scope of the proposed 'permitted purposes', i.e. the purposes for which monies collected through mandatory practising fees can be applied by approved regulators.

4.78. Some respondents raised issues that had been explored in the original consultation. For example, the extent to which staff and admin costs were included within the scope of the permitted purposes was a concern for many consultees.

4.79. In the Response to Consultation published in September[15], the LSB said at paragraph 4.93 that the permitted purposes should be understood as covering 'associated or incidental costs', which would include any administrative or staff (salary, pension or otherwise) costs where those costs were accrued in relation to work under any of the permitted purposes. The LSB said that conduct and discipline costs – which would include the costs of disciplinary tribunals – fall squarely within the ambit of the term "regulation" as used in the Act and in the (then) draft rules. And it said that entity costs were by definition covered (by reference to section 207 of the Act).

4.80. The LSB considers that all of these issues have, therefore, been covered and that there is no need to re-open discussion about extending the permitted purposes in those cases. Indeed, it is in the interests of all involved to interpret the existing permitted purposes widely, rather than having to supplement narrow interpretations with prescriptive extensions.

4.81. Accordingly, **no change is considered necessary to widen the permitted purposes in respect of costs associated with or incidental to regulation etc**. Because of the sensitivities involved, however, some further remarks might be helpful insofar as the management of pensions are concerned.

4.82. Some (if not all) approved regulators provide pension plans as part of their overall employee remuneration strategy. Certain liabilities in respect of those pension plans will have accrued prior to the making of the PFRs. However, some or all of those liabilities might need to be met following the coming into force of the rules. The LSB sees no difficulty with such past liabilities being met by practise fee monies. At the time that liabilities were incurred, it was commonly understood that practising certificate revenues would be applied for such purposes. Moving forwards, new liabilities in respect of pensions (and any other incidental or ancillary costs associated to the permitted purposes, which will include employment and admin-related costs) will also fall to be permitted, so long as they are associated or incidental to functions that are themselves permitted purposes.

[15] See above, footnote 3.

4.83. Some further issues were raised too. First, the Master of the Faculties submitted that, although the permitted purposes included payment of the LSB/OLC levy, they did not appear to include any reference to the payment of any financial penalty levied on the approved regulator under section 37. The LSB agrees with the Master of the Faculties' analysis. Accordingly **the permitted purposes have been extended in respect of the payment of financial penalties**.

4.84. Second, some consultees considered that 'work carried out with a view to improving access to justice' should be made a permitted purpose. The LSB considers that this proposal, potentially, goes too far. For example, much of the work that the Law Society suggested might fall within the category could already fall within the ambit of other permitted purposes. The only example that would not naturally fit elsewhere was described as "negotiating the terms of contracts and work in relation to Best Value Tendering".

4.85. Plainly, the idea of negotiating with the Government and Legal Services Commission in respect of the fees paid to lawyers could have an impact on the availability of legal advice and therefore to the access to justice agenda. But the LSC is under statutory obligations to ensure legal aid clients have access to services which effectively meet their needs. While the Law Society, or indeed any other approved regulator, will have experience and expertise in such matters, it is also likely that approved regulators would exercise their functions so as to represent members of the profession, to secure the best outcome for those members. Otherwise, one would expect the independent and impartial regulatory arms of such bodies to be lobbying for the extension of the permitted purposes.

4.86. In the 2004 Clementi report, Sir David said:

> "the potential conflict between regulatory and representative issues is most clear in those issues which deal with the negotiation of fees for lawyers. Both the Law Society and the Bar Council have fought hard in recent years on behalf of their members in connection with rates for legal aid work. It is reasonable that a representative body should use its influence in the interests of its members to raise remuneration levels funded by the State; but the function of representing members in such matters sits uneasily with the regulatory responsibility to act in the public interest"[16].

4.87. The LSB agrees. The work undertaken by approved regulators in their capacity as professional bodies will often have as its principal object securing better rates of pay for its members. This is perfectly legitimate activity. However, it is neither regulatory, nor does it fall demonstrably to be categorised as a wholly or mainly objective public interest work. The principal relevant interest – however legitimate – is that of the profession. Accordingly, **an 'access to justice' permitted purpose will not be included in the PFRs**.

4.88. The following Chapter goes on to summarise the representations made in consultation submissions. The summary should help to contextualise the analysis set out in the preceding paragraphs of this Chapter.

[16] Clementi report (see footnote 6 above): paragraph 17, page 29.

# 5. Summary of responses

5.1. Chapter 3 introduced responses received by the LSB. It gave a high-level breakdown of who responded and which issues were raised. Chapter 4 then analysed the key issues and set out the LSB's decisions in respect of each of them. This chapter now summarises the specific representations made, so adding context to the previous chapters.

***Response summary***

5.2. The consultation paper, deliberately, posed no specific questions on matters of policy or principle. The paper did, however, seek comments on the proposed rules. It also raised the issue of how best to see the finalised rules implemented effectively and within a reasonable timeframe. Comments received can broadly be categorised as falling under either one of these heads.

5.3. Most respondents chose to comment on the draft rules in the order set out in the paper. Many restricted their comments to draft provisions on which, for them, particular concerns remained. The larger approved regulators and regulatory arms provided a wider ranging narrative on the package of proposals put forward, as well as looking in detail at many of the specific provisions on which representations were sought.

## Internal Governance Rules

*Section A – Definitions*

5.4. Following the principles-rules-guidance framework adopted, Rule 1 defined what the LSB meant by 'the principle of regulatory independence'. Rule 2 went on to introduce (or rather define for the first time) in the IGRs the concepts of 'lay person', 'prejudice' and 'undue influence'. Various other terms were defined, all or most of which were carried over from the previous iteration of draft rules consulted upon in March.

5.5. With one exception, respondents were generally content with the proposed definitions. Some submissions called for drafting changes to clarify meaning, but such comments did not bear on matters of substance.

5.6. The exception, however, did concern a matter of substance. The issue was with the proposed definition of 'lay person'. The LSB's proposed definition was carried over from the Act. Schedule 1 of the Act provides for, among other things, the constitution of the LSB. There is a requirement for a certain proportion of the Board to be lay members. The Act then defines 'lay' as (in effect) meaning anyone who is not and has never been an authorised person (i.e. qualified as a lawyer).

5.7. The practical effect of the proposed IGR definition would be to govern who could be deemed a lay member of the ring-fenced regulatory bodies required under the rules.

Because of the requirement for lay majorities, this was a particularly significant issue for many stakeholders.

5.8. There was almost blanket opposition to the LSB's proposed definition. The lone voice in support of the suggested definition – which was the only 'consumer group' voice among the cohort of 18 respondents – was that of the LSB's Consumer Panel Chair.

> *"The proposed definition of a 'lay person' is the correct approach. The LSB would need strong evidence to depart from the definition applicable to its own governance arrangements under the Legal Services Act, which was finally settled after much debate during the passage of the legislation. The ability to bring a lay perspective relies on the cultural mindset of the individual concerned, so it would be misleading, not to mention arbitrary, to set a time period of non-practice after which a qualified person could be considered lay. A situation conceivably could emerge that all members are legally qualified and count as lay; this would not breed public confidence in the independence of regulation"*
>
> **LSB Consumer Panel Chair**

5.9. However, for strongly articulated reasons, the vast majority disagreed. For example:

- the Bar Council and Bar Standards Board highlighted that because barristers are called to the Bar after completing their academic and vocational training, there are many 'barristers' who have never (and indeed never intended) to practise law;

- the Law Society considered that a once-qualified lawyer who has no experience of recent practise (say over the previous 10 years) should, so long as they can demonstrate substantial experience in other fields, be eligible to sit on regulatory boards as lay persons. The perspective they bring is likely to be quite different from practising lawyers, and it is that perspective that will be of benefit to the boards; and

- the two intellectual property Institutes and their regulatory arm suggested that solicitors and barristers, for example, provided substantially the same 'outside' perspective as other professionals like accountants and architects. The highly specialised work of regulated persons here means that those who are not trade mark or patent attorneys (i.e. regulated by the Institutes) should genuinely be considered 'lay', regardless of whether they have a qualification in another professional field, be it legal or otherwise.

5.10. Objections were both principled – i.e. the proposed definition is unnecessary – and grounded in practicalities. In terms of the latter, several approved regulators suggested that, if the LSB required full compliance within a relatively short period, the proposed definition could expose them to initial criticism for non-compliance. This could lead to regulatory action from the LSB or exposure to liability for cutting short existing contracts, neither of which would (if they were to occur) bring any, or

any significant, benefit. Furthermore, a turnover of membership in a relatively short period of time could destabilise boards by removing extensive experience, expertise and leadership, as well as deflecting attention from the important job of regulation.

5.11. Proposed alternatives included definitions that would see 'lay person' meaning 'any person not regulated by the approved regulator' or 'any person who has not been entitled to practise as an authorised person for [say] 10 years'.

- The LSB decision on the definition of 'lay' is set out in Chapter 4 at paragraphs 4.31 and 4.35.

- **The LSB has decided that the term 'lay person' should continue to be defined by reference to the template provided by the Act**. Importantly, all concerned (including consumers and the public more widely) should understand absolutely what is meant by the term.

*Section B – Application of the rules*

5.12. As proposed Rules 3 to 5 concerned technical application of the rules to approved regulators – which is a legal requirement under the Act – no consultee made specific comment in relation to these provisions. However, the respondents from the accountancy sector did make comment about the application of some of the specific provisions of the IGRs to prospective approved regulators from other professional sectors. Those comments are summarised below, under Section D (see from paragraph 5.17 onwards).

*Section C – General duty of each approved regulator*

5.13. Section 30 of the Act requires the LSB to make rules applicable to each (i.e. every) approved regulator. While proposals outlined in the first consultation in March would have applied wholly or mainly to those approved regulators which have representative responsibilities, the latest set of proposals made clear that certain requirements must be met by those approved regulators which do not have representative responsibilities.

5.14. Neither the Council for Licensed Conveyancers nor the Master of the Faculties – the two current regulators which have no representative functions – was concerned about this new provision. Accordingly, the LSB will adopt this approach in the rules that it now makes formally.

*Section D – Additional requirements for certain approved regulators*

5.15. The proposed IGRs defined as AARs those approved regulators that have responsibility for regulatory functions. The rules then imported certain wider obligations, over and above the general duty biting on all approved regulators, with which it was proposed AARs must also comply. These specific obligations were set out in the proposed Schedule to the IGRs.

5.16. The detailed observations put by respondents about the scheduled provisions are summarised below (from paragraph 5.23). However, two points are of relevance here. First, most if not all respondents were content with the approach adopted, whereby AARs are required to meet additional requirements as laid out in the Schedule. Second, the two accountancy body respondents were concerned about the proportionality of any requirement on them to meet the conditions set for AARs.

5.17. The argument advanced by the accountancy bodies was thus. There is a distinction to be drawn between:

(a) approved regulators which exercise no representative functions, and so which would need to comply only with the general duty which must (by law) bite on all approved regulators;

(b) approved regulators which exercise both representative and regulatory functions, where such regulators have been established to oversee the work of professionals involved wholly or mainly in the provision of legal services. This category would include the six approved regulators currently designated on the face of Schedule 4 and which would become AARs under the IGRs; and

(c) other regulators, which do have representative functions, but which regulate only certain reserved legal services that are ancillary to the bulk of the work they regulate. Therefore the focus of 'representative' work is on the core sector overseen by the regulator, rather than on the legal services sector.

5.18. The accountancy body respondents call category (c) above 'third category regulators'. The discrete area of legal services which they will look to regulate (probate work) is very much ancillary to their 'day job' of regulating accountants. Following on from this, two broad points are made:

- first, while it may be entirely proportionate to require approved regulators to conform to a traditional 'legal services regulator' model when their regulated communities wholly or mainly practise law, if the 'legal services' function is ancillary to a regulator's role, it is not necessarily proportionate to demand excessive structural or governance changes[17]. This is particularly the case where the demands of other oversight regulators (principally here, the Financial Reporting Council, Financial Services Authority and Insolvency Service) will also have to be met; and

- second, while 'third category' regulators intend to regulate reserved legal activities, there is no way of knowing, at this stage, how many professionals will look to be so regulated by them. Accordingly, it would again be disproportionate to expect substantial organisational and

[17] Standards of front-line regulation (i.e. that applicable to practitioners authorised to undertake reserved legal activities) are not in issue here. These representations relate purely to the governance structures that approved regulators are required to have in place in order to satisfy the requirements of the Legal Services Act and the Internal Governance Rules made under it.

governance structures to be put in place at least until it is clear that sufficient people will be regulated by those new structures.

> *"prospective [third category] regulators have particular IGR issues relevant to them, their members and consumers which are not shared by the other categories listed. Here the IGR requirements could prove a barrier, and so a barrier to the wider provision of reserved legal services"*
>
> **Institute of Chartered Accountants of England and Wales**
>
> *"the LSB should be aware of the risk that a 'one size fits all' approach may lessen the impact of the Rules"*
>
> **Association of Chartered Accountants**

- The LSB decision on the status of new approved regulators which are also supervised by other oversight regulators is set out in Chapter 4 in paragraph 4.6.

- **the LSB has varied the definition of 'Applicable Approved Regulator' so as to clarify the position of regulators principally supervised by oversight regulators in other professional sectors**. Importantly, the approved regulators affected by the change will still be required to meet the general duty imposed by the IGRs, which is set out in Rules 6 and 7. However, the application of the Schedule to the IGRs will not be automatic. It will be for the LSB and each affected approved regulator to agree what arrangements must be made, in particular so as to ensure compliance with the general duty.

*Section E – Implementation and compliance*

5.19. Responses to the LSB's first 'regulatory independence' consultation – and particularly those from approved regulators – were overwhelmingly supportive of a self-certification model to manage implementation of the rules. In its Response to Consultation document published in September, the LSB announced that it intended to proceed with its dual self-certification proposals.

5.20. No respondent sought to move the LSB on this point. Indeed, those responses which touched on the idea of dual self-certification were supportive of the concept. Accordingly, the model will be included in the final rules to be made by the Board.

5.21. After the formal consultation exercise had closed, the LSB met with approved regulators to discuss how the mechanics of dual self certification might best be made to work. In consultation with those bodies, the LSB has created a template certificate to be submitted as part of the dual self-certification process.

- The LSB decisions on implementation issues are set out in Chapter 6.

- The template certificate for AARs to complete is included at ***Annex C***.

*Section F – Guidance*

5.22. No comments were made in relation to proposed Rules 12 or 13. If approved regulators, or prospective approved regulators would welcome additional guidance, the LSB would be happy to consider representations made.

*The Schedule – Additional requirements for AARs*

5.23. The Schedule to the IGRs sets out the requirements to be met by AARs, i.e. the approved regulators which are responsible for both regulatory and representative functions.

5.24. Generally, respondents were content with the Schedule's framework of principles, rules and guidance, which was set out in tabular form. There were, however, points of detail over which concerns remained, or where clarification was sought.

*Schedule: Part 1 – Governance*

> *Nothing in an Applicable Approved Regulator's (AAR's) arrangements should impair the independence or effectiveness of the performance of its regulatory functions.*
>
> **LSB's Governance Principle**

5.25. No respondent sought to argue against the **principle** set out in Part 1 of the Schedule.

5.26. The proposed **Rule A** would require each AAR to delegate responsibility for performing all regulatory functions to a regulatory body. The Law Society suggested that the LSB should make clearer that the regulatory body referred to in the rule could be an arm of the AAR, and not necessarily a separate legal entity in its own right. The Bar Council suggested that the rules should make clear that it should be a regulatory arm, not a separate entity. Otherwise, no comments were made.

5.27. It is the intention of the LSB to be as flexible as possible in constructing its rules. The interpretation of the Law Society is consistent with the outcome the LSB seeks to achieve. There would be little difficulty in clarifying the rules in that way. However, the Bar Council's suggestion could unwittingly restrict flexibility. For example, it seems to the LSB perfectly reasonable for an AAR to create a subsidiary company (whether wholly-owned by the AAR or not) for the purpose of managing the regulatory functions of the AAR. The subsidiary would be a legal entity in its own right. But it would satisfy the requirements of the LSB in this respect.

- Rule A in Part 1 of the IGR's Schedule has been amended so as to include the words 'whether or not a separate legal entity/separate legal entities' after the requirement to delegate regulatory functions to a body or bodies.

5.28. Insofar as the illustrative **guidance** supporting Rule A was concerned, three respondents expressed views in respect of the provisions bearing on the ability of AARs to issue guidance to practitioner members on regulatory matters. However, no respondents suggested that change was necessary and so the LSB is content that the guidance is appropriate.

5.29. **Rule C** was more contentious. The rule has two parts, in that it seeks to require:

- a majority of lay persons on the board of respective regulatory bodies; and
- the appointment of a chair, without restriction based on legal qualifications held or not held by applicants/candidates.

5.30. The second limb of the rule was generally accepted. However, two respondents (both of whom were individual solicitors) argued that the chair of regulatory boards should always be drawn from the regulated community. One respondent (the chair of the LSB's Consumer Panel) suggested that the arguments were finely balanced. In particular, the submission suggested that if AARs appointed solely lawyer chairs over the first five year period, it might be difficult to argue that the competitions being run were genuinely as open as the LSB was seeking to require.

5.31. Subject to those three views, there was broad consensus for the LSB position. However, there was no such consensus over the proposed requirement for lay majorities.

5.32. The Bar Council and Bar Standards Board questioned whether the LSB had any legal basis for seeking to make the proposed rule. A further seven respondents expressed strong opposition to the proposal. Only one respondent voiced support for the proposal, with another suggesting they could see a weight of argument behind it.

5.33. It is worthy of comment that far from all of the respondents united against the proposed requirement for lay majorities were in fact opposed to the idea of lay majorities. Indeed, two of the approved regulators and two regulatory arms were in favour of a lay majority regulatory board, but considered that the LSB was over-stepping the mark by seeking to *require* it.

5.34. The underlying argument was that strict rules (regardless of their motives) can sometimes create unintended consequences. What is vital is that good quality people are selected and appointed. The best people are – and the best team is – easiest to appoint where flexibility pervades. So whether grounded in policy, or more strictly in law, respondents urged the LSB to re-think.

> *"The BSB favours a majority of non-lawyers and intends to move to a majority of non-lawyers when it is able to do so, but the prime concern is ensuring that it always has the highest quality members. The BSB does not agree, however, with the LSB's suggestion that the IGRs should require that regulatory boards should be constituted with an in-built majority of non-lawyers."*
>
> **Bar Standards Board**

- The LSB decision on the requirement for lay majorities for regulatory boards is set out in Chapter 4 at paragraph 4.21.

- **the LSB has retained its policy requirement for lay majorities for regulatory boards** and the finalised IGRs reflect that policy line.

*Schedule: Part 2 – Appointments etc*

> *(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; (2) All persons appointed to regulatory boards must respect the duty to comply with the requirements of the Legal Services Act 2007.*
>
> **LSB's Appointments Principle**

5.35. No comments were made on the framing of the **principles** in Part 2 of the Schedule. Nor was any comment made in respect of **Rule A**, which would require all regulatory board appointments to be made on the basis of merit.

5.36. The **guidance** in relation to Rule A was commented on by four respondents (one approved regulator, one regulatory body, one approved regulator jointly with its regulatory body, and the LSB Consumer Panel Chair), none of which adopted exactly the same stance. The proposed guidance suggested that AARs should either delegate control of the appointments process in respect of regulatory board members or, alternatively, that they should ensure that the regulatory body has 'very strong involvement at all stages'.

5.37. Of those four respondents, two were generally content with the framing of the guidance and considered that they were already well-placed to comply. The remaining two requested the LSB to consider changing its guidance. First, the SRA suggested that the LSB should make clear that the envisaged 'strong involvement' short of control should entail genuine partnership. Second, the LSB Consumer Panel Chair said that she was as yet unpersuaded that full control should not be delegated. Accordingly, the LSB was asked to set out its case more robustly.

5.38. The LSB's position here was again premised on the desire to achieve maximum flexibility, balanced against the need to ensure appropriate outcomes. The purpose of the rules being made is to ensure adequate separation of regulatory and

representative functions. It would be possible to comply with that requirement in a number of ways.

5.39. It might be possible, for example, to maximise the independence of a regulatory body as a self-contained unit, or to create the ring-fenced arm and then seek to supervise it through a genuinely independent oversight board. If the oversight board complied fully with the requirements of separation, then there should be no principled objection to that body controlling the appointments process for the regulatory body. The key is that the principle of regulatory independence (as now defined in the IGRs) must be met.

5.40. In respect of **Rule B** and the supporting guidance proposed, few substantive comments were made. However, the Law Society and SRA did make the following observations:

- it is not necessarily appropriate to insist on lay majorities for appointments panels. In answer to that point, the LSB does not read the principles, rules or guidance in Part 2 of the Scheduled table as necessarily importing such a requirement, although of course whatever arrangements are put in place must ensure the necessary separation of 'regulation' from 'representation'. Lay majorities on appointment panels could be a powerful indicator of appropriate independence; and

- it might be sensible to clarify what role the LSB considers chairs (whether current/out-going and/or in-coming) of regulatory boards should have in the appointment process. The present guidance could leave room for doubt. In the LSB's view, however, the current degree of specificity is probably as far as is necessary to go. Additional detail, so long as compliant with the over-arching principles and rules, should be for the AAR and its regulatory body.

5.41. **Rule C** and its supporting **guidance** concerned decisions on remuneration, appraisal, re-appointment and discipline in respect of regulatory board members. In summary, the provisions would see delegation of control over such issues from the AARs to regulatory boards. While most respondents raised no issue with what was proposed, three respondents did highlight concern in respect of the remuneration point.

5.42. Submissions highlighted that the FRC's Combined Code on Corporate Governance makes certain provisions about how the function of setting boardroom pay is to be exercised. It would be inconsistent with that Code if the regulatory board were to set its own pay and conditions for itself. A separate remuneration committee, which complies with the Combined Code requirements, should instead undertake the function of dealing with such issues.

❖ The LSB decision on board-level remuneration is set out in Chapter 4 at paragraph 4.50.

❖ **Insofar as board-level remuneration is concerned, the IGR's guidance has been clarified to highlight the principle of separation**. There are likely to be

various models from which AARs can choose. Short of establishing genuinely independent corporate boards, however, the LSB can envisage few instances where anything short of constitutional delegation to the regulatory body would suffice – even if in practice the end result is a shared remuneration committee mechanism.

5.43. **Rule D** and its supporting **guidance** dealt with a specific issue under the 'discipline' heading. The proposed rule would require AARs to seek LSB concurrence (not to be unreasonably withheld) before dismissing any member of its regulatory body's board. The guidance then suggested that the LSB should be consulted privately over any other disciplinary action planned, and the AAR should consider whatever representations the LSB might make thereafter.

5.44. The Bar Council was very firmly opposed to the stricter rule, although was content with the supporting guidance. The SRA, on the other hand, agreed with the LSB's proposed rule and guidance. No other respondent commented.

5.45. The Bar Council's point was grounded in the wider concerns about the way in which the proposed IGRs unduly restrict (or potentially unduly restrict) it from acting effectively in its capacity as approved regulator. As approved regulator, the Bar Council will have continuing duties under the Act, for example under section 28. It will also, for example, have liabilities as employer in relation to the staff it employs, whether under the auspices of its representative functions or its regulatory ones. In some situations, the Bar Council will need to act decisively because it is exposed to liability elsewhere and awaiting LSB concurrence (which might not in the end be given) would be an intolerable fetter.

- The LSB decision on concurrence prior to dismissal is set out in Chapter 4 at paragraph 4.53.

- **The IGRs continue to require approved regulators to approach the LSB if they wish to dismiss a member of the regulatory board**, although we have sought to clarify the accompanying illustrative guidance.

5.46. In respect of **Rule E**, which would require AARs to ensure that no member serving on a regulatory board was also responsible for any representative functions, there was general agreement. However, the **guidance** accompanying the rule was felt by some to go too far, or at least to state the proposition too baldly.

5.47. The guidance suggested that, where possible, regulatory board appointees should not have been responsible for representative functions immediately prior to appointment; and that the longer the gap between holding any 'representative' and 'regulatory' functions, the more likely the LSB will be to conclude that the principle of regulatory independence has been met.

5.48. The Law Society submission suggested that rules and guidance should not seek to make black and white that which is liable to have (legitimately) several shades of grey. While the cross-fertilisation from some roles classified as 'representative' might assist a regulatory board, it would clearly be wrong for more than a small

number to have long 'representative' CVs. Further, the Law Society asked for clarification about what 'representative' means in this context. In particular, should it extend to membership of local law societies and/or special interest groups like the Black Solicitors Network? Or should it more narrowly be defined as meaning having had a role in the approved regulator that was deemed under the Act to be 'representative'?

5.49. First, the 'shades of grey' argument is precisely why the LSB proposed to make provisions like this in guidance, rather than principles or rules. However, the LSB generally considers that the principles and rules made will be best served by observing the guidance proposed. It will be for AARs to make determinations in their own individual circumstances and be prepared to justify the outcome if and when questioned.

5.50. Second, on the definition of 'representative', the LSB principally had in mind roles within approved regulators connected with the representation or promotion of the profession. But again, there needs to be a balance. AARs should be extremely slow to appoint a cohort of non-lay board members where each appointee was an immediate past president of a local representative society, for example. That said, experience of black and minority ethnic issues facing the profession – in the Law Society's example – might be very relevant and beneficial background for an incoming board member.

*Schedule: Part 3 – Strategy and resourcing*

> *Persons performing regulatory functions must have the freedom to define a strategy of their choosing for the performance of those functions; and work to implement that strategy independently.*
>
> **LSB's Strategy and Resources Principle**

5.51. The **principle** set out in the third part of the Schedule's table built upon the analysis of the LSB in its Response to Consultation document published alongside the supplementary consultation on the draft rules. In that document, the LSB said that 'it would be wrong for regulatory arms to set their own budgets without oversight or challenge, but it would be equally wrong for approved regulators effectively to veto proposed strategy by withholding necessary resources'.

5.52. While most respondents chose not to comment directly on the wording of the proposed principle, some did. ILEX and IPS noted the LSB's shift to a more principles-based form of regulation and were pleased to see the flexibility that followed from it. However, the Bar Council argued that it is of fundamental importance to acknowledge that the regulatory arm's remit to set strategy cannot be seen in isolation from resourcing, and that resourcing is a matter for the approved regulator in accordance with the Act. The LSB should beware of over-stepping the ambit of its discretion when making rules in this area.

*"Implicit within the acceptance that the regulatory arm does not have the authority to set its own budget and require the AR to hand over the required sum is the fact that it also cannot decide upon a strategy in isolation from the resource implications of that choice for the AR. This should be explicit in the rules rather than left to the guidance. Equally, having been allocated resources to undertake a particular strategy, it would be inappropriate for the regulatory arm to assume that the sums provided are thereafter ring fenced to be used as seen fit regardless of the original budgetary purpose. It is of fundamental importance that the latter point is acknowledged in both Principle 3 and the associated rules".*

**The Bar Council**

5.53. The Bar Council's line of argument was extended to **Rule A** and the guidance which supported it. The proposed rule sought to provide that 'defining and implementing strategy' (as per the over-arching principle) included:

- ensuring access to financial and other resources reasonably required to meet the strategy adopted;
- ensuring effective powers of control over those resources; and
- ensuring the freedom to govern all internal processes and procedures.

5.54. The Bar Council suggested that the third of those three bulleted provisions is too wide in that it pays insufficient regard to the position and continuing duties of the designated approved regulator. The regulatory body is not, in colloquial terms, an island, but an arm of the AAR which has delegated to it certain functions. Those functions must be carried out to a standard that is satisfactory to the AAR, which is ultimately responsible for discharging the given functions.

5.55. Further, the provision requiring 'effective control' over resources would be appropriate up to a point. However, it would not be appropriate for the rule to be read as affording license to a regulatory body to allocate resources to purposes other than those for which it had been agreed through the budgeting process that they would be assigned. The Bar Council's submission said that 'virement is an elemental budgetary discipline that has universal application; it is not an independence issue'.

- ❖ The LSB decision on the general control of strategy and resources is set out in Chapter 4 at paragraphs 4.64 and 4.65.
- ❖ **The LSB has clarified its illustrative guidance so as to highlight the objective of genuine separation.** In addition, the over-arching principle now **clarifies that strategy and resource management can never be wholly divorced from the mechanisms for AAR oversight of their respective regulatory bodies**.

5.56. The Bar Council was also concerned about the **guidance** that supported the rule. In particular, it supported the Law Society's line of argument in respect of the LSB's

proposed guidance on the management of staff. In summary, the suggested guidance would see AARs ensuring that their regulatory bodies were given control over line management; that conflicts of interest were managed; and that, so long as within agreed budgets and after appropriate consultation, the regulatory bodies should be free to determine levels of pay and conditions for regulatory staff. The guidance also suggested that AARs should not exercise their over-riding powers as employers (where indeed they are employers of regulatory staff) without the concurrence of the regulatory body and in any event with due regard to the principle of regulatory independence.

> *"The Law Society is a single employer. Staff are members of Society-wide pension schemes and other benefit schemes such as private medical cover, gym membership etc where significant economies of scale are achieved through corporate membership. A unilateral right for the regulatory arm to set different conditions for regulatory staff would be unacceptable, and is inconsistent with the Board's general approach to these issues.*
>
> **The Law Society**

5.57. ILEX and IPS also made the point that, as ILEX is the employer in relation to staff engaged in functions under IPS, it is ultimately responsible for issues like terms and conditions. The SRA registered its strong support for the proposals, as set out in the consultation document. Other than the accountancy bodies, no other respondent comments on these issues directly.

- The LSB decision on management and control of employees is set out in Chapter 4 at paragraph 4.58.

- **The LSB has revised its illustrative guidance in respect of line management and control of staff**.

5.58. In similar vein, the Law Society and the Bar Council were opposed to **Rule B** (a power for regulatory bodies to do anything calculated to facilitate the carrying on of its functions), which they suggested should be deleted or much changed; whereas the SRA fully supported the provision.

5.59. **Rule C** would require AARs to have in place fair and transparent budget-setting processes. Most respondents were content with the flexibility afforded to AARs. One respondent sought clarification over the wording of the consultation paper's commentary that the budget mechanism 'must approve the budget proposed by the regulatory arm' (paragraph 3.21[18]). Another respondent sought clarification that the LSB did indeed expect regulatory arms to be responsible for proposing their budgets, and that the mechanism adopted under the IGRs would then determine the extent to which that proposal was to be agreed.

[18] http://www.legalservicesboard.org.uk/what_we_do/consultations/2009/pdf/consultation_160909.pdf

5.60. The LSB confirms:

- the consultation paper's commentary should not be read as meaning – nor was it intended to mean – that the mechanism 'must approve' proposals from the regulatory arm *irrespective* of the outcome of any consideration. We agree that such a suggestion would be entirely wrong; and

- it is envisaged that regulatory bodies should be responsible for proposing budgets, which should then be considered and ultimately approved subject to whatever variation is thought necessary. Proposed budgets from regulatory bodies should be thorough, well argued and transparent. Control mechanisms to approve such proposals must, in the main, resist interfering in matters that are legitimately for the regulatory body. But a scrutiny process, with robust checks and balances, should ensure a fair and reasonable outcome whilst protecting the principle of regulatory independence.

5.61. **Rule D** would require AARs to have in place suitable arrangements for determining disputes involving the provision of commonly-sourced corporate services. The proposal was premised on the broad and general understanding that 'shared services' (so long as appropriately managed) are both a natural feature of the Clementi Model B+ and likely to bring significant advantages in terms of efficiencies.

5.62. Most respondents agreed to this rule, although the SRA suggested that the LSB should be required formally to approve any 'shared services' mechanisms. However, in respect of the proposed **guidance** accompanying the rule, the Law Society and the Bar Council suggested that the current drafting was too simplistic. The common argument between the two organisations concerned the hypothetical case where the internal dispute resolution mechanism breaks down and a regulatory body reasonably believes its independence and/or effectiveness is impaired.

❖ The LSB decision on the use of dispute resolution mechanisms is set out in Chapter 4 at paragraph 4.68.

❖ **Guidance has been updated to clarify that due regard should be had to internal dispute resolution mechanisms, in place under the IGRs, before a regulatory body seeks to vary arrangements for shared services**.

*Schedule: Part 4 – Oversight etc*

> *Oversight and monitoring by the AAR of persons performing its regulatory functions must not impair the independence or effectiveness of the performance of those functions.*
>
> **LSB's Oversight and Monitoring Principle**

5.63. In relation to this **principle**, the Bar Council reiterated the argument about the approved regulator bearing ultimate responsibility for the functions it delegates under the IGRs. Accordingly, it suggested that the liability and responsibility of the AAR should be acknowledged under the principle. This would, suggested the Bar Council, clarify the position of AARs in circumstances where their regulatory arms fail to meet the standards required.

- The LSB decision on the oversight principle is set out in Chapter 4 at paragraph 4.72.

- **The LSB has amended the drafting of the 'oversight' principle**, which deals with the way in which approved regulators oversee their regulatory bodies, to reflect the complexities inherent in the 'separation' model.

5.64. **Rule A** would require AARs to ensure that any arrangements in place in respect of oversight, monitoring etc (while of course complying with the over-arching principles) must be transparent and proportionate. **Rule B** went on to provide that arrangements must prohibit the AAR from intervening, or making directions, in respect of the management or performance of regulatory functions unless with the concurrence of the LSB.

5.65. Subject to the Bar Council's over-arching point of principle, no other substantive comments were made on the issues raised by these rules. In respect of the guidance supporting the rules, with one exception, no comments were made. The exception was that one respondent suggested the LSB should indicate in guidance that AARs should ensure a clear separation between their 'oversight functions' and any 'representative functions'. This is clearly a matter bearing on the spirit of the Act and the IGRs. The LSB considers the requirement to be a central tenet of the IGRs. However, mindful of the diversity of the approved regulators, it is considered more appropriate to leave the IGRs unaltered at this stage.

## Practising Fee Rules

5.66. As previously found, respondents tended to focus much of their comments on the IGRs rather than the PFRs. Of course, the latter were pitched at a much higher level, leaving much of the detail to be agreed between the LSB and individual approved regulators. So the room to make detailed observations at this stage was necessarily limited.

5.67. However, some respondents did comment on particular provisions within the proposed rules. Two areas received significant comment. Other more technical points were made in respect of other issues.

*Applicable persons*

5.68. Section 51(8) of the Act introduces the concept of 'relevant authorised persons' as meaning authorised persons (in effect lawyers) who are authorised by an approved regulator to undertake reserved legal activities. The concept of relevant authorised

persons was then applied to the section's provisions on the 'permitted purposes', i.e. the purposes for which approved regulators are entitled to apply funds raised through mandatory practise fee mechanisms. The effect was that LSB rules must allow approved regulators to apply practise fee monies to the regulation etc of relevant authorised persons.

5.69. In its first consultation paper on regulatory independence, the LSB carried the concept of relevant authorised persons into its proposed PFRs without variation. Responses to the consultation, summarised in the LSB's Response document, highlighted the limitations of such an approach and the LSB agreed that the rules should be changed. The supplementary consultation accordingly sought views on the new concept of 'applicable persons', which was designed to replace 'relevant authorised persons'.

5.70. The term 'applicable person' was defined as including relevant authorised persons but extending to others over which (whether by virtue of current or previous membership of the approved regulator) the approved regulator has regulatory powers.

5.71. In broad terms, the LSB's proposed change was welcomed. However, in one respect, some approved regulators suggested that further change was necessary. The issue concerned the 'current or previous membership' stipulation included in the proposed definition. The Bar Council/BSB and the Law Society/SRA all made the point that the scope of their regulatory powers over barristers and solicitors respectively is not necessarily rooted in a relationship between the lawyer belonging to the professional body. Reference to membership is therefore too restrictive.

> *"Because barristers are called to the Bar by one of the four Inns of Court on successful completion of the Bar Vocational Course (or Bar Professional Training Course from 1 September 2009), there are many non-practising barristers who are not, nor ever have been, members of the Bar Council. Nonetheless, the BSB does have jurisdiction over anyone who is currently a member of the Bar, regardless of whether they pay the voluntary Member Services Fee".*
>
> **Bar Standards Board**

5.72. The case put by all such respondents was helpfully articulated and persuasive. Accordingly, the LSB has removed reference to membership in the finalised version of the PFRs. The definition will now include relevant authorised persons (as defined in section 51(8)) but also extend 'to other persons over which the Approved Regulator has regulatory powers'.

- The LSB decision on defining 'applicable persons' is set out in Chapter 4 at paragraph 4.76.

- **The PFRs include an amended definition of 'applicable persons' which extends to all those over whom approved regulators have regulatory reach**.

5.73. One point of clarification ought to be made too. In the iteration of the draft PFRs published in September for consultation, the definition of 'applicable persons' extended to 'those… holding themselves out as [regulated] persons'. This part of the definition was included after a letter from the SRA dated 31 July[19] raised an issue about 'policing the perimeter'.

5.74. The basic point was that, in the context of the solicitors' profession, the Law Society/SRA sometimes investigates and takes action against non-solicitors pretending to be qualified. This is a significant issue of public protection, and is a legitimate activity to be funded out of practicing fee funds. This work, and that involving once-qualified solicitors who have fallen off the Roll by reason of non-payment of practicing fees, for example, needs to be included within the scope of the purposes permitted under the PFRs.

5.75. Accordingly, the definition of applicable persons was amended for that very reason. However, the response document published alongside the supplementary consultation paper omitted to explain the change. It is therefore necessary and important to explain, in this document, the change and the reasons behind it.

*Permitted purposes*

5.76. Most comments in respect of PFRs were aimed at the permitted purposes. Seven respondents submitted that the permitted purposes proposed in the supplementary consultation were too narrow and that the finalised rules should accordingly be extended.

5.77. In summary, some of the issues raised included:

- explicit reference should be made in respect of costs that are ancillary to the permitted purposes, including the costs of staff (including salaries and pension contributions) and of general administration;
- if there is any doubt, explicit reference should be made to the effect that costs associated with conduct and discipline, including running apparatus like tribunal hearing panels, should fall within the permitted purposes;
- whether or not permitted purposes would include funding work on applications to develop new practice rights for members/registrants, rather than purely in relation to rights that already exist; and
- that the permitted purposes should extend to cover work in relation to entity-based regulation, rather than the regulation of individual practitioners/registrants only.

[19] See: http://www.legalservicesboard.org.uk/what_we_do/consultations/closed/pdf/regulatory_independence/solicitors_regulation_authority_c.pdf

- ❖ The LSB decision on clarifying the permitted purposes in respect of incidental costs is set out in Chapter 4 at paragraph 4.81.

- ❖ **No change is considered necessary to widen the permitted purposes in respect of costs associated with or incidental to regulation etc**. Because of the sensitivities involved, however, the LSB has made some remarks insofar as the management of pensions are concerned.

5.78. Beyond these issues, further issues were raised. First, the Master of the Faculties submitted that, although the permitted purposes included payment of the LSB/OLC levy, they did not appear to include any reference to the payment of any financial penalty levied on the approved regulator under section 37.

- ❖ The LSB decision on permitting the recovery of financial penalties is set out in Chapter 4 at paragraph 4.83.

- ❖ **The permitted purposes have been extended in respect of the payment of financial penalties**.

5.79. Secondly, the Law Society, the Bar Council and the City of Westminster & Holborn Law Society suggested that 'work carried out with a view to improving access to justice' should be included as a permitted purpose. Indeed, the Law Society suggested that the LSB had failed adequately to explain why it had not accepted a similar suggestion made in the original consultation.

5.80. The Law Society's response notes that a lot of its work in the 'access to justice area' would already fall within other permitted purposes, whether participation in law reform and the legislative process, or as promotion of human rights and fundamental freedom. However, the Society goes on to say:

> "negotiating the terms of contracts and work in relation to Best Value Tendering – although crucial to ensure the continued availability of legal aid and providers – does not naturally fall under [other permitted purposes]. The improvement of access to justice is one of the statutory regulatory objectives, and it would be peculiar for the Legal Services Board not to recognise that in setting the permitted purposes."

- ❖ The LSB decision on extending the permitted purposes to cover 'access to justice' work is set out in Chapter 4 at paragraph 4.86

- ❖ **An 'access to justice' permitted purpose will not be included in the PFRs**.

*Miscellaneous practising fee issues*

5.81. Various other technical points were raised. For example:

- some respondents sought clarity over whether PFR applications are to be submitted (and managed generally) by regulatory bodies, rather than their over-arching approved regulators. Because of the mandatory nature of

practising fees and the framework that necessarily goes with them, the LSB does believe that the application process forms part of the regulatory arrangements of an approved regulator and so that, under the IGR provisions, control of the process should be delegated;

- one approved regulator asked whether it would be allowed to spend monies raised through practising fees on developing new practise rights, or whether the permitted purposes extended only to the regulation of those rights for which the body was currently authorised. The LSB considers that the former, rather than the latter, interpretation is correct;

- one approved regulator sought clarification over applications for practise fee approval where the proposed fee amounted clearly to a *de minimis* increase on previous years. Costly processes should not be necessary where no, or no significant, benefit would ensue. In the LSB's response to the original consultation[20], it was said that: '[t]he general rule would be that minimal changes would be unlikely to require significant if any consultation further than professional/representative bodies – whether that professional/ representative body was the residual approved regulator or institutionally separate'. The LSB continues to hold that view; and

- one approved regulator questioned why the PFRs required, as part of the practise fee applications, evidence showing anticipated income from other sources that would be applied to permitted purpose activities. This provision was inserted primarily for the purpose of ensuring maximum transparency. While the LSB will ultimately have oversight of all fees charged mandatorily or otherwise as part of an approved regulator's regulatory arrangements, publication of data under the PFRs will ensure that those paying the fees see where their money is being applied. Those paying members/practitioners/ others can then hold the approved regulator to account on the basis of that information provided.

5.82. This document now goes on to focus on the implementation issues and to publish the finalised Rules.

[20] Paragraph 4.105 of the earlier Response to Consultation – see footnote 3 above.

# 6. Implementation next steps

6.1. In the supplementary consultation paper, an indicative timetable for implementation was proposed. The conclusions reached by the LSB are set out in this Chapter.

6.2. In terms of the task faced by the AARs and others, the reforms honed by these rules have been in the pipeline for some years. Many – although admittedly not all – approved regulators have been working towards this point since publication of the Clementi review in 2004. Implementation issues must be considered in that context.

## Practising Fee Rules

6.3. In respect of PFRs, the rules will come into force in January 2010 and each approved regulator will need to work with the LSB informally in order to prepare for submitting formal applications during 2010. One-to-one working will be required with each approved regulator. The LSB has started the necessary engagement process with some approved regulators. It will soon write to all such bodies to ensure plans are put in place in good time for work to get underway.

## Internal Governance Rules

6.4. The IGRs are more complicated. In summary, the consultation paper proposed that AARs should be asked to certify compliance (or provide action plans which would see them brought into compliance) by 30 April 2010. The LSB would then have to respond by no later than 31 July 2010. The certificate, developed by the LSB in consultation with AARs, for the dual self-certification process is included at ***Annex C***.

6.5. The LSB hosted a seminar for AARs on 6 November. Issues concerning the implementation of the rules (including in particular the timetable for rules coming into effect) and the mechanics of the dual self-certification model were considered.

6.6. The working assumption of the LSB was that it would not be reasonable to expect full compliance by each AAR by 30 April. Instead, it was envisaged that the LSB would be receiving action plans, rather than full certificates, from many or all of the AARs. The proposals set out in the consultation paper said that such action plans should see the AAR meeting the requirements of the IGRs within a *reasonable* time, with an explanation of how that compliance will be achieved.

6.7. The LSB has decided that, while it will fall for each AAR to propose action plans (including timetables) for their own particular circumstances, the LSB's over-arching framework should require AARs to be able to demonstrate full compliance with the IGRs by no later than six months after submission of action plans, unless it can be demonstrated that that would be disproportionate. The LSB will be writing to all AARs on that basis.

6.8. The LSB will also be writing to those approved regulators that will not be AARs about the arrangements that they will need to put in place under the IGRs. While each such body will have its own individual circumstances, the LSB will want to ensure that the spirit of the Act and the IGRs made under it is maintained.

# 7. Finalised rules

7.1. The Legal Services Board has, on 9 December 2009, made the following rules under Legal Services Act 2007 (c.29), section 30(1) and section 51(3) and (6):

## INTERNAL GOVERNANCE RULES 2009

### A. DEFINITIONS

1. In these Rules, a reference to "the principle of regulatory independence" is a reference to the principle that:

   **structures or persons with representative functions must not exert, or be permitted to exert, undue influence or control over the performance of regulatory functions, or any person(s) discharging those functions.**

2. The words defined in these Rules have the following meanings:

| | |
|---|---|
| **Act** | the Legal Services Act 2007 (c.29) |
| **Applicable Approved Regulator** | an Approved Regulator that is responsible for the discharge of regulatory and representative functions in relation to legal activities in respect of persons whose primary reason to be regulated by that Approved Regulator is those person's qualifications to practise a reserved legal activity that is regulated by that Approved Regulator |
| **Approved Regulator** | has the meaning given in Section 20(2) of the Act |
| **Board** | the Legal Services Board |

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| **Consumer Panel** | the panel of persons established and maintained by the Board in accordance with Section 8 of the Act |
| **lay person** | has the meaning given in Schedule 1, paragraphs 2(4) and (5) of the Act |
| **legal activities** | has the meaning given by section 12(3) of the Act |
| **OLC** | the Office for Legal Complaints established under Section 114(1) of the Act |
| **person** | includes a body of persons (corporate or unincorporated) |
| **prejudice** | the result of undue influence, whether wilful or inadvertent, causing or likely to cause the compromise or constraint of independence or effectiveness |
| **regulatory board** | has the meaning given by Rule B in Part 1 of the Table in the Schedule to these Rules |
| **regulatory functions** | has the meaning given by Section 27(1) of the Act |
| **regulatory objectives** | has the meaning given by section 1(1) of the Act |
| **representative functions** | has the meaning given by Section 27(2) of the Act |
| **representative interests** | the interests of persons regulated by the Approved Regulator |

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| **reserved legal activities** | has the meaning given by section 12(1) of the Act |
| **undue influence** | 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. |

## B. WHO DO THESE RULES APPLY TO?

3. These Rules are the rules that the Board has made in compliance with 30(1) of the Act relating to the exercise of Approved Regulators' regulatory functions.

4. Accordingly, these Rules apply to each Approved Regulator.

5. In the event of any inconsistency between these Rules and the provisions of the Act, the provisions of the Act prevail.

## 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.

## D. REQUIREMENTS FOR APPLICABLE APPROVED REGULATORS

8. In the case of each Applicable Approved Regulator, the arrangements in place under Rule 6 must also meet the requirements set out in the Schedule to these Rules.

## E. ENSURING ONGOING IMPLEMENTATION

9. Each Applicable Approved Regulator, jointly with its regulatory board, must:

(a) if it considers itself to be compliant with these Rules, certify such compliance in the form and manner prescribed by the Board from time to time; or

(b) if it considers itself not to be compliant with these Rules, in some or all respects, notify such non-compliance and set out:

(i) why it has been unable to comply in such respects as it has identified;

(ii) when it considers that it will be compliant; and

(iii) how it plans to achieve compliance, and by when, and how much it is expected to cost.

10. Subject to the agreement of the Board, an Applicable Approved Regulator may invite any other appropriate body, including a consumer panel associated with the Applicable Approved Regulator, to provide a certification in a similar form and manner.

## F. GUIDANCE

11. Approved Regulators must, in seeking to comply with these Rules, have regard to any guidance issued by the Board under this Rule.

12. For the avoidance of doubt, any guidance issued under Rule 11 does not, of itself, constitute a part of these Rules.

# Schedule to Internal Governance Rules

The requirements set out in this Schedule are that Applicable Approved Regulators, in making arrangements under these Rules, must:

(a) adhere to the principles set out in the table below in respect of specified areas which arrangements must cover;

(b) comply with the rules set out in the table below in respect of demonstrating compliance with the principles; and

(c) take account of the illustrative guidance set out in the table below when seeking to comply with the principles and rules.

| Principle | Rule | Illustrative guidance |
|---|---|---|
| **Part 1: Governance**<br><br>Nothing in an Applicable Approved Regulator's (**AAR's**) arrangements should impair the independence or effectiveness of the performance of its regulatory functions. | **A.** 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 '**the regulatory body**' or '**the regulatory bodies**'). | 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. |
| | | 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:<br>• ensure that it does not contradict or add material new requirements to any rules or guidance made by the regulatory body/bodies; and<br>• consult with the regulatory body/bodies when developing that guidance. |

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| | **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 '**regulatory board**'). | |
| | **C.** In appointing persons to regulatory boards, AARs must ensure that:<br>• a majority of members of the regulatory board are lay persons; and<br>• 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. | |
| **Part 2: Appointments etc**<br><br>(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. | **A.** 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. | If regulatory boards do not lead on managing the appointments process, it should have a very strong involvement at all stages. |
| | | 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. |
| | **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. | Appointment panels or equivalent should be established following the guidance set out in the Board's letter of 2 December 2008[21]. |
| | | 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). |

[21] See: http://www.justice.gov.uk/news/docs/legal-services-board-open-letter-021208.pdf

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| | | The appointments process should be conducted with regard to the desirability of securing a diverse board with a broad range of skills. The framework applied at Schedule 1 paragraph 3 of the Act serves as a useful template. |
| | **C.** Decisions in respect of the remuneration, appraisal, reappointment and discipline of persons appointed to regulatory boards must respect the principle of regulatory independence and the principles relating to "appointments etc" set out in this Part of this Schedule. | • Remuneration – decisions in respect of regulatory board pay and conditions should be made having regard to best practice and in any event should not be controlled wholly or mainly by persons responsible for representative functions;<br>• Appraisals – while persons with representative functions may be consulted about regulatory board members' appraisal, they should not be involved formally in agreeing the outcome, or future objectives;<br>• Reappointments – decisions should be guided by objective appraisals and the desirability of ensuring a balance between regular turnover and continuity. |
| | **D.** Except insofar as an AAR would be, or would reasonably be considered likely to be, exposed to any material legal liability (other than to pay wages, salaries etc) as a consequence of the delay required to obtain | While the LSB accepts that there may be exceptional reasons which justify immediate dismissal without concurrence having first been obtained, it would expect a full explanation if such circumstances were ever to arise. An AAR should accordingly be prepared to justify why it could not comply with the relevant Rule. |

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| | the concurrence of the Board, no person appointed to a regulatory board must be dismissed except with the concurrence of the Board. | Where an AAR proposes to discipline one or more member(s) of a regulatory board, where such discipline is short of dismissal, the Board should be consulted privately in advance of the action being taken, and the AAR should consider any representations the Board may chose to make. |
| (2) All persons appointed to regulatory boards must respect the duty to comply with the requirements of the Legal Services Act 2007. | **E.** No person appointed to and serving on a regulatory board must also be responsible for any representative function(s). | Where possible, a person appointed should not have been responsible for any representative functions immediately prior to appointment.<br>The longer the gap between holding responsibility for representative functions and taking up regulatory functions, the more likely it is that the principle of regulatory independence will be observed. |
| | | Codes of conduct or equivalent for board members should highlight the importance of observing and respecting the regulatory objectives and the principles of better regulation, rather than operating to represent any one or more sectoral interests.<br>Codes should also highlight the importance of respecting the principle of regulatory independence, as underlined by the provisions of sections 29 and 30 of the Act. |
| **Part 3: Strategy and Resources etc**<br><br>Subject only to the oversight permitted under Part 4 of this | **A.** Defining and implementing a strategy should include:<br>• access to the financial and other resources reasonably required to meet the strategy it has adopted;<br>• effective control over the management of | The Act requires separation of regulatory and representative functions. Absent of corporate management structures that are robustly and demonstrably separated from the control of persons with representative functions, these Rules are likely to require a high degree of delegation to regulatory bodies in respect of the control of strategy and resourcing. |

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| Schedule, persons performing regulatory functions must have the freedom to define a strategy for the performance of those functions and work to implement that strategy independently of representative control or undue influence. | those resources; and<br>• the freedom to govern all internal processes and procedures. | What is or is not a regulatory function is determined in accordance with the Act. Subject to the Act, whether something is 'regulatory' should be for each regulatory body to determine, in close consultation with respective AARs. |
| | | Where members of staff are employed by an AAR to discharge regulatory functions under the delegated remit of a regulatory body, the position of the AAR as legal employer should be recognised in the arrangements made under these rules. However, in complying with these Rules, those arrangements should make clear how decisions with respect to the management and control of such members of staff are to be exercised.<br>The presumption under such arrangements should be – subject only to being exposed to unreasonable liability (such as in creating a pension scheme) – that an AAR should always agree a reasonable request from its regulatory body. While an AAR has a right of veto, therefore, it also carries a responsibility to justify that decision in light of the principle of regulatory independence.<br>The Board may from time to time issue further illustrative guidance on these issues under Rule 11 of these Rules. |

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| | | Each regulatory body should act reasonably when defining and implementing its strategy, and should in particular have regard to the provisions of Section 28 of the Act. It should also have due regard to the position of the AAR and in particular to any responsibilities or liabilities it may have as AAR. |
| | **B.** The regulatory body (or each of the regulatory bodies) must have the power to do anything within its allocated budget calculated to facilitate, or incidental or conducive to, the carrying out of its functions. | Each regulatory body should act reasonably when exercising its functions in accordance with this Rule, and should in particular have regard to the provisions of Section 28 of the Act. It should also have due regard to the position of the AAR and in particular to any responsibilities or liabilities it may have as AAR. |
| | **C.** Insofar as provision of resources is concerned, arrangements must provide for transparent and fair budget approval mechanisms. | The process established by the AAR should provide appropriate checks and balances between it and the regulatory body (or bodies) so as to ensure value for money and observe the wider requirements of the Act, without impairing the independence or effectiveness of the regulatory body (or bodies). |
| | **D.** Insofar as provision of any non-financial resources is concerned (for example, services from a common corporate service provider, or staff), arrangements must provide for transparent and fair dispute resolution mechanisms. | Subject only to the formal budgetary approval process and the operation of its dispute resolution mechanism(s) , an AAR's arrangements should not prevent those performing regulatory functions, where they believe their independence and/or effectiveness is compromised or prejudiced, from obtaining required services otherwise than through the AAR. |
| | | AARs and regulatory bodies should be particularly careful to ensure that, in respect of public and/or consumer-facing services (including media relations and marketing-type activities), the principle of regulatory independence should be seen to be met, as well as |

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| | | being met. |
| | | When considering whether arrangements meet the required standards, the Board will consider factors such as:<br>• evidence that the provision of services to the regulatory body (or bodies) is not subordinate to the provision of services to any other part of the AAR;<br>• provision being made for service level agreements agreed between respective parties; and<br>• transparent, fair and effective dispute resolution mechanisms being in place. |
| **Part 4: Oversight etc**<br><br>Oversight and monitoring by the AAR (which is ultimately responsible and accountable for the discharge of its regulatory functions) of persons performing its regulatory functions must not impair the independence or effectiveness of the performance of those | **A.** Arrangements in place must be transparent and proportionate. | In making its arrangements, an AAR should balance its ultimate responsibility for the discharge of regulatory functions with its responsibilities to ensure separation of regulatory and representative functions. |
| | | In considering proportionality, AARs should consider the risk of Board intervention. Note the Board's policy statement on compliance and enforcement powers, and in particular the Board's intention to use its most interventionist powers only when other measures (including informal measures) have failed. |
| | **B.** Arrangements in place must prohibit | In determining whether to give concurrence, the Board will consider |

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| functions. | intervention, or the making of directions, in respect of the management or performance of regulatory functions unless with the concurrence of the Board. | the extent to which the process leading to the proposed intervention or directions complies with the principle of regulatory independence. |

# PRACTISING FEE RULES 2009

## A. DEFINITIONS

1. The words defined in these rules have the following meanings:

| | |
|---|---|
| **Act** | the Legal Services Act 2007 (c.29) |
| **Applicable persons** | includes “relevant authorised persons” as defined in Section 51(8) of the Act but extends also to other persons over which the Approved Regulator has regulatory powers |
| **Approved Regulator** | has the meaning given in Section 20(2) of the Act |
| **Board** | the Legal Services Board |
| **Consumer Panel** | the panel of persons established and maintained by the Board in accordance with Section 8 of the Act |
| **legal services** | means services provided by a person which consist of or include “legal activities” as defined by Section 12(3) and 12(4) of the Act |
| **permitted purposes** | the purposes which an Approved Regulator may apply amounts raised by practising fees, as set out in Rule 6 of these Rules |
| **person** | includes a body of persons (corporate or unincorporated) |

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| **practising fees** | has the meaning given by Section 51(1) of the Act |
| **regulatory functions** | has the meaning given by Section 27(1) of the Act |
| **reserved legal services** | has the meaning given in Section 207(1) of the Act. |

## B. WHO DO THESE RULES APPLY TO?

2. These Rules are the rules that the Board has made in compliance with 51(3) and 51(6) of the Act relating to the control of practising fees charged by Approved Regulators.

3. Accordingly, these Rules apply to each Approved Regulator that proposes to charge practising fees as part of its regulatory arrangements.

4. In the event of any inconsistency between these Rules and the provisions of the Act, the provisions of the Act prevail.

## C. THE PERMITTED PURPOSES

5. Monies raised through practising fees must not be applied for any purpose other than one or more of the permitted purposes.

6. The permitted purposes are:

   (a) the regulation, accreditation, education and training of applicable persons and those either holding themselves out as or wishing to become such persons, including:

      (i) the maintaining and raising of their professional standards; and

(ii) the giving of practical support, and advice about practice management, in relation to practices carried on by such persons;

(b) the payment of a levy imposed on the Approved Regulator under section 173 of the Act and/or the payment of a financial penalty imposed on the Approved Regulator under section 37 of the Act;

(c) the participation by the Approved Regulator in law reform and the legislative process;

(d) the provision by applicable persons, and those either holding themselves out as or wishing to become such persons, of legal services including reserved legal services, immigration advice or immigration services to the public free of charge;

(e) the promotion of the protection by law of human rights and fundamental freedoms;

(f) the promotion of relations between the Approved Regulator and relevant national or international bodies, governments or the legal professions of other jurisdictions;

(g) increasing public understanding of the citizen's legal rights and duties.

## D. THE APPROVAL MECHANISM

7. Where an Approved Regulator proposes to charge practising fees as a part of its regulatory arrangements, the Approved Regulator must apply to the Board for approval of the level of that practising fee.

8. In making an application under Rule 7, an Approved Regulator must comply with the provisions of this Part of these Rules.

9. In respect of each Approved Regulator, the Board will set out from time to time:

(a) a timetable including key decisions and submission dates that must be observed by the Approved Regulator and the Board respectively;

(b) the persons that should be consulted by the Approved Regulator before submitting its application;

(c) the criteria against which the Board will decide on applications put to it; and

(d) the evidence required by the Board to satisfy it against the agreed criteria.

10. Insofar as the criteria mentioned in Rule 9 (c) are concerned, the Board and Approved Regulator should have regard to factors including the following:

(a) evidence which demonstrates that reasonable care was taken in settling the application in the context of the budget necessary for the immediate and medium term;

(b) evidence which demonstrates that the revenue raised through the practising fee charge will be applied solely to purposes which are permitted purposes;

(c) clarity and transparency over the revenue raised through practising fees to be applied for permitted purposes which are regulatory functions;

(d) clarity and transparency over the revenue raised through practising fees to be applied for permitted purposes which are not regulatory functions; and

(e) evidence that persons paying practising fees will have explained to them how revenue raised through the charging of practising fees will be applied as between the Approved Regulator's performance of regulatory functions and any other functions also carried on by the Approved Regulator.

11. Insofar as the evidence mentioned in Rule 9 (d) is concerned, the Board and Approved Regulator should have regard to factors including the following:

(a) a description of how the application was developed and settled, including any consultation carried out, whether or not such consultation was required by the Board;

(b) a budget showing anticipated income from practising fees, all other expected income to be applied to permitted purposes and planned expenditure of income against the permitted purposes;

(c) 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;

(d) an explanation of contingency arrangements where unexpected regulatory needs arises in-year;

(e) evidence of how the previous year's practising fee income was allocated only to permitted purposes; and

(f) a regulatory and diversity impact assessment.

12. In considering an application submitted to it under this Part of these Rules, the Board reserves the right to consult any person it considers appropriate. In particular, it reserves the right to consult the Consumer Panel about the impact of the proposed fee on persons providing non-commercial legal services.

13. If the Board approves an application under this Part of these Rules, it must notify the Approved Regulator concerned.

14. If the Board does not approve an application under this Part of these Rules, it must:

(a) notify the Approved Regulator concerned;

(b) give reasons for its decisions;

(c) require the Approved Regulator to submit a revised application which addresses the Board's reasons for withholding approval previously; and

(d) specify the circumstances (if any) in which the Approved Regulator may charge a limited practising fee under its regulatory arrangements as an interim measure pending consideration and approval of its full application.

# Annex A – List of respondents

Submissions lodged by the following 18 respondents are available online at:

http://www.legalservicesboard.org.uk/what_we_do/consultations/closed/submissions_fee_rules.htm

1. **Association of Chartered Certified Accountants**
2. **The Bar Council**
3. **Bar Pro Bono Unit**
4. **Bar Standards Board**
5. **Chartered Institute of Patent Attorneys**
6. **City of Westminster and Holborn Law Society**
7. **Council for Licensed Conveyancers**
8. **Crown Prosecution Service**
9. **Ian Lithman**
10. **ILEX and IPS**
11. **Institute of Chartered Accountants in England and Wales**
12. **Institute of Trade Mark Attorneys**
13. **Intellectual Property Regulation Board**
14. **John Penley**
15. **The Law Society**
16. **LSB Consumer Panel**
17. **Master of the Faculties**
18. **Solicitors Regulation Authority**

# Annex B – Impact Assessment

**Introduction**

1. The Legal Services Board (LSB) is the body created by the Legal Services Act ('the Act') to oversee the regulation of the legal profession. The LSB regulates the front-line regulators of legal professionals who are engaged in the provision of reserved legal services. Those front-line regulators are called 'approved regulators' (ARs) under the Act. From January 2010, the Act will recognise ten ARs[22], each of which will be designated as such under Part 1 of Schedule 4 of the Act.

2. Some of the ARs are responsible for 'representative functions' (as defined by section 27(2) of the Act), as well as for the 'regulatory functions' (as defined by section 27(1) of the Act) overseen by the LSB. A principle underlying the Act is that regulation should be independent of undue representative influence or control. It is that requirement for regulatory independence which is the focus of this impact assessment.

**What is the problem under consideration? Why is intervention necessary?**

3. The Act sets out a new legal framework for the regulation and oversight of the legal profession and industry. In accordance with section 30(1) of the Act, the LSB must make Internal Governance Rules (IGR). Such rules must set out requirements to be met by ARs for the purpose of ensuring that their regulatory and representative functions are appropriately separated. The rules must include provision which ensures that persons exercising regulatory functions can, independently from any representative functions, make representations to certain bodies (including notifying the LSB if they feel that their independence or effectiveness is being compromised). The rules must also provide that persons charged with discharging an AR's regulatory functions are appropriately resourced to carry out those functions.

4. In accordance with section 51(3) and (6), the LSB must make the Practising Fee Rules (PFR). Again, section 51 provides that certain provisions must be made when the LSB makes its rules. In particular, the rules must prescribe the "permitted purposes" (i.e. the purposes for which ARs may apply monies raised through a mandatory practising fee levy on their practitioner members/registrants). Section 51(4) provides that certain permitted purposes must be prescribed. The rules must also set out the requirements to be met by ARs when apply to the LSB for approval of the level of practising fees to be levied.

5. The LSB published a preliminary impact assessment alongside its consultation paper, *Regulatory Independence*, in March 2009[23].

[22] The ten ARs are: the Law Society, the General Council of the Bar, the Master of the Faculties, the Institute of Legal Executives, the Council of Licensed Conveyancers, the Chartered Institute of Patent Attorneys, the Institute of Trade Mark Attorneys, the Association of Law Costs Draftsmen, the Association of Chartered Certified Accountants and the Institute of Chartered Accountants of Scotland.

[23] *Regulatory Independence* consultation paper, see main paper footnote 2, above. The impact assessment was published at Annex C of that paper.

6. The LSB considers that the costs involved in complying with its IGR and PFR will be small but wider impacts will potentially be positive.

7. Those directly impacted by these rules will be the current Approved Regulators (ARs) and those seeking to become ARs.

**What are the policy objectives and the intended effects?**

8. At the broadest level, when making the IGRs and PFRs the LSB must act in a way which (1) is compatible with the regulatory objectives[24], (2) is considered by the LSB to be most appropriate for meeting those objectives[25], (3) has regard to the principles of better regulation and to any other principle appearing to it to represent best regulatory practice[26] and (4) has regard to the principle that its principal role is one of oversight[27]. Those are the general objectives of the LSB in respect of making rules and exercising powers under those rules.

9. Insofar as specific objectives are concerned, and in the context of the duties set out above:

   (a) in relation to the IGR, the LSB considers that it is important that –

   - the rules made should seek to maximise public and consumer confidence in the integrity and effectiveness of the regulatory framework. The reality and perception of regulation being managed independently from the profession will be important;
   - the regulated community should be able to recognise and accept that the regulatory framework is fair and fit for purpose. In particular, individual members of the legal profession should have confidence in the expertise and integrity of those that are regulating them; and
   - the rules should fix clear principles and then require each AR to apply those principles in light of the circumstances of their own branch of the profession; and

   (b) in relation to the PFRs, the LSB considers that it is important that –

   - where charges are levied on members of the profession as a mandatory part of the authorisation process, any funds raised should only be applied for purposes that are demonstrably regulatory in nature or that serve some other public interest function. Membership fees for purely representative purposes should not be a *mandatory* part of any authorisation process;
   - the process by which ARs set and then levy charges from their regulated community should be as transparent as possible. If practitioners are paying for their own regulation, maximum transparency

[24] LSA07, section 3(2)(a). The regulatory objectives are themselves set out in Section 1(1) of the Act.
[25] LSA07, section 3(2)(b).
[26] LSA07, section 3(3)(a) and (b).
[27] For example, see LSA07, section 49(3).

can allow them – and the wider public – to hold those spending the money to account. That accountability will be a core component of building a framework that ensures trust and confidence; and

- the rules are flexible enough to meet the diverse needs (including the need to fit with budgeting cycles) of different ARs across the system. Without this flexibility, we imagine that the system will find it extremely difficult to function effectively, or at all

**What policy options have been considered? Please justify any preferred option**

10. The LSB must make the IGRs and PFRs. In so doing, it must also include certain mandatory provisions in those rules. This Impact Assessment has therefore not considered a '**do nothing**' or base case option, as the theoretical option would be contrary to the LSB's statutory obligations.

11. Initial policy proposals were formulated on the basis of the provisional impact assessment published at the time.

12. In developing its policy since that stage, the LSB has considered evidence (including in the form of consultation responses from stakeholders) in five key policy areas, namely:

    - internal governance models generally;
    - appointments etc to regulatory boards
    - the management and control of strategy and resourcing
    - residual supervisory and oversight arrangements for ARs;
    - IGR implementations issues generally; and
    - arrangements for practising fee approval, and in particular in defining the "permitted purposes".

13. In general, the policy model adopted by the LSB is one which affords as much flexibility for ARs as would be consistent with the principles settled by the Act and through earlier consultation by the LSB.

14. The specific arrangements adopted by each AR will determine the ultimate impact and in particular the costs accrued as a result of compliance. At this stage, it is not possible to predict how different ARs will model their arrangements and so precise quantification of impacts (costs and benefits) has not been attempted.

***Internal governance generally***

15. Application of the IGR to ARs is a matter of law. Under the provisions of the Act, ARs are obliged to make certain arrangements irrespective of the framework of rules

issued under the Act. This was debated during passage of the Legal Services Bill so no assessment is made here as to the cost or benefit of such provisions.

16. Options identified by the LSB included:

- requiring ARs to conform to a model set of arrangements, with detailed provisions prescribed in all areas considered relevant and important;
- identifying higher-level principles and incorporating those into a framework under with each AR would be required to define their own individual arrangements; and
- either of the above models, but in addition enabling flexible application of specific provisions under criteria which reflect the principles under which regulatory action should be (among other things) proportionate and targeted only at cases in which action is needed.

17. The second option, with the additional characteristics of the third option was the basis of proposals originally consulted[28] upon. However, consultation submissions[29] indicated that the principles set out by the LSB were still, in parts, too prescriptive to be proportionate in the circumstances. Analysis of those submissions was set out in the Response to Consultation[30], published in September.

18. The LSB therefore proposed, in its supplementary consultation paper[31] a revised framework of principles, rules and guidance. In addition, it retained the emphasis on targeting rules only where needed by developing the concept of 'Applicable Approved Regulator' (AAR).

19. The IGR now impose a general duty on all ARs – such duty applying as a direct and specific consequence of the Act – and a further duty imposed only on AARs, to comply with the schedule of principles and rules, and to have regard to the illustrative guidance set out there too. In summary, the principles, rules and illustrative guidance cover four discrete areas of governance:

- the requirement to delegate regulatory functions (as defined in the Act) to a body that is independent of and has no representative functions;
- the appointment, reappointment, appraisal and discipline of members appointed to the boards of those independent regulatory bodies;
- the management and control of regulatory bodies' strategy and resources; and

[28] See main paper, footnote 2. The *Regulatory Independence* Consultation Paper was published in March 2009.
[29] Submissions lodged in response to the March-June consultation were published online website: http://www.legalservicesboard.org.uk/what_we_do/consultations/closed/submissions_regulatory.htm
[30] See main paper, footnote 3.
[31] See main paper, footnote 1.

- residual oversight by ARs of the persons delegated responsibility for the discharge of its regulatory functions.

20. The AAR concept has been further honed through the supplementary consultation process. The LSB has varied the definition of 'AAR' so as to clarify the position of regulators principally supervised by oversight regulators in other professional sectors.

21. The LSB is now content that the IGR framework is as compliant with the better regulation principles – and in particular with respect to proportionality and targeting – as is practicable having regard to the duty to further the regulatory objectives.

***Appointments etc***

22. Provisions about appointments made to regulatory boards (i.e. the boards to which responsibility for regulatory functions is to be delegated) in the main is based upon external best practice requirements and/or the specific provisions made by the Act.

23. In one particular respect, the IGR framework is likely result in additional costs for some or all ARs. Rule C in Part 1 of the IGR's Schedule requires regulatory boards to be established with a majority of members who are "lay persons". The term lay person is defined by the rules by reference to Schedule 1 paragraphs 2(4) and (5) of the Act. In effect, a person is a lay person if they or not and never have been an 'authorised person' (which broadly means qualified as a lawyer).

24. As paragraph 23 of the preliminary impact assessment suggested:

> "...at least some of the smaller regulators are constituted at present by an overwhelming majority of elected representatives acting, in effect, pro bono for the good of the organisation. Although sometimes expenses are covered, the resulting bill is insignificant. Any requirement under section 30 rules to ensure sufficient proportion of independent persons involved with discharging regulatory functions will entail additional cost where previously there was none. Unlike larger bodies, smaller approved regulators are more likely to see costs escalate, in percentage terms, dramatically".

25. Clearly, the IGR will have an impact. Despite seeking specific evidence as to the quantification is such an impact, no AR provided any indicative costings. The work necessary to design appropriate arrangements, recruit and select suitable independent members and then pay those members will entail cost. While we have no reason to believe such costs will be disproportionate – no AR suggested in consultation submissions that the effect of the rule itself would necessarily be disproportionate – we have included proportionality as a particular focus for implementation . The LSB can therefore continue to work with ARs to ensure that impacts are not disproportionate having regard to the principles in the regulatory objectives.

***Strategy, resources and oversight***

26. The rules developed in respect of strategy, resourcing and oversight, require arrangements to be put in place to demonstrate that the principles embedded in the Act and the IGR are respected. However, they stop short of requiring a specific model to which all ARs must conform.

27. This approach was broadly welcomed by ARs. It is not possible to envisage specific impacts flowing from the decisions each individual AR might take. However, it is clear that these areas are key insofar as the ability of those to whom responsibility has been delegated to operate and be seen to operate independently is concerned. Arrangements are therefore required, and must be observed, if ARs are to avoid regulatory action taken by the LSB in future. Compliance costs are therefore a natural consequence of the operation of the Act, so some impact under the rules now made is inevitable.

***Implementation issues generally***

28. Those ARs that are AARs will be asked to certify compliance with the IGR. A dual self-certification mechanism has been developed through which that certification can be made. That model met almost universal approval through consultation exercises. In particular, it was considered the most proportionate mechanism that the LSB could employ to ensure implementation and onward compliance (which is a necessary part of making rules).

29. Central to the analysis of impact will be the way in which – and in particular the timetable on which – the IGR are implemented. Options on time scales would include:

- requiring full compliance by a specific date for all AARs; and
- requiring AARs to propose timetables on which full implementation was reasonable, and agree those timelines individually with the LSB

30. The LSB thinks it would be unreasonable to require each AAR to ensure full compliance with the IGR too quickly. The different stages of each AAR's development must be recognised. Equally, the rules being made are being made because they are necessary and so full compliance cannot be delayed unreasonably.

31. AARs will be required to submit joint certificates (i.e. certificates signed jointly by AARs and their respective regulatory bodies) by 30 April 2010, or to provide action plans which would see them brought into compliance. A working assumption has been made that, rather than certificates, AARs will submit action plans because most or all AARs will not find it possible to ensure full compliance by the end of April.

32. While it will fall for each AAR to propose action plans (including timetables) for their own particular circumstances, the LSB's over-arching framework should require AARs to be able to demonstrate full compliance with the IGRs by no later than 6

months after submission of action plan, unless it can be demonstrated that that would be disproportionate.

33. The 6-month stipulation is necessary to ensure that the implementation process is transparent – i.e. consumers, practitioners and the public at large know in broad terms what the regulatory regime requires of AARs. The proportionality caveat is necessary so as to ensure that no undue harshness results.

34. In considering proportionality, factors which the AARs and the LSB will have to take into consideration are likely to include:

- the cost of any remedial action required and in particular the opportunity cost of focusing resources of such remedial action rather than on other priorities;
- the size of the regulated community of the AR and so likely impact on consumers across the sector; and
- the extent to which practitioners or registrants are required to be regulated by the AR in order to practise (and so the risk that additional regulatory costs will result in practitioners opting out of regulation).

***Permitted purposes***

35. The impact of the PFRs on ARs is likely to be negligible, beyond that which is an automatic consequence of the coming into force of the Act.

36. In response to AR and other evidence, the LSB has extended the permitted purposes from the minimum requirements set out in the Act. The LSB has also clarified its understanding of the breadth of those statutory provisions.

**When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?**

37. We expect to review the IGRs and PFRs by the end of 2011/12 in order to consider early operation and links with the introduction of a licensing regime for ABS.

***Annual Costs***

38. One-off (transition): £ small but unquantifiable.

39. Average annual cost (excluding one-off): £ small but unquantifiable.

***Annual Benefits***

40. One-off: £ negligible. The increased confidence in the regulatory framework may bring benefits for smaller ARs insofar as making the regulatory regime more attractive and so bring in more revenue from practitioners/registrants paying practising fees.

41. Average annual benefit: £ small but unquantifiable.

**What is the geographic coverage of the policy/option?**

42. England and Wales.

**On what date will the policy be implemented?**

43. Early 2010 will see the LSB taken on full powers but transitional arrangements will apply prior to this to ease the implementation of the Act.

**Which organisation will enforce the policy?**

44. The LSB.

**Does enforcement comply with Hampton principles?**

45. Yes.

**Will implementation go beyond minimum EU requirements?**

46. The rules made by the LSB in respect of internal governance and practise fee approval were made under a legislative framework fixed by domestic legislation. EU law does not impose specific obligations in that respect.

**What is the value of the proposed offsetting measure per year?**

47. Nil or negligible.

**What is the value of changes in greenhouse gas emissions?**

48. Nil.

**Will the proposal have a significant impact on competition?**

49. No.

**Annual cost (£-£) per organisation (excluding on-off)**

50. Small: small but unquantifiable; Medium: small but unquantifiable; Large: small but unquantifiable.

***Are any of these organisations exempt?***

51. No. However:

- Internal Governance Rules will exempt from the automatic duty to comply with scheduled rules certain approved regulators where those regulators have no

representative functions, or where they do have representative functions but should otherwise on grounds of proportionality be so exempted; and

- Practising Fee Rules will be applied with proportionality in mind. For example, where any practising fee application sought approval for a fee level that was subject only to minimal change from previous years, requirements in respect of (for example) consultation may be waived.

**Impact on Admin Burdens Baseline (2009 Prices)**

52. Increase of £: slight.

53. Decrease of £: approximately nil (although potential for small decrease).

54. Net Impact £: slight.

**Evidence Base**

55. We consider that the cost of these changes is significantly below the generally accepted threshold of £5 million costs, below which an impact assessment is not necessary. However, we believe that in setting out how we have considered the various elements of the impact assessment will help us consider future impacts as they arise.

***Competition***

56. We believe that a principles-based approach provides ARs and prospective ARs the flexibility to innovate on how to meet the regulatory objectives in a proportionate manner that is appropriate to their particular regulated community and market sector. We believe that this will allow existing ARs to amend existing arrangements and thus promote better regulation. It will also allow new ARs the freedom to mitigate risks to, and promote, the regulatory objectives at the lowest appropriate cost.

***Small Firms Impact Test***

57. The regulated community is diverse and that is likely to continue as the Act takes effect, although we will need to monitor the impact of the changes. The contents of the rules for both IGRs and PFRs are proportionate in that they set the same principles and objectives for both large and small ARs but give freedom for a proportionate level of regulation – thus allowing a small regulator freedom to meet the principles and requirements in a proportionate manner. This proportionality will be fed down to the regulatory community through both the cost of the practicing fee and the cost of regulatory compliance and thus will serve to protect small firms from a one size fits all regulatory framework.

***Legal Aid***

58. We expect minimal impact through rules, although greater competition between ARs and within regulated community may enhance the competitiveness of the Legal Aid market.

***Race/Disability/Gender equalities***

59. There is no direct or indirect impact expected. However, competition between ARs may enhance the opportunity for proportionate and flexible regulation. The focus of the rules on the regulatory objectives may promote equalities in the longer term as they provide for proportionate risk assessment and response.

***Human Rights***

60. In promoting a proportionate response to risks the rules proposed are likely to protect Human Rights.

***Rural Proofing***

61. There is no direct or indirect impact expected. However, competition between ARs may enhance the opportunity for proportionate and flexible regulation. Similarly the commitment to proportionate regulation may protect small firms that are often found in rural areas. The focus of the rules on the regulatory objectives, such as promoting access to justice, may protect and promote rural services in the longer term.

***Sustainability, carbon emissions, environment and health***

62. There is no impact expected on sustainability, carbon emissions, environment and health.

# Annex C – Dual self-certification certificate

The LSB held a seminar on 6 November to discuss the implementation of the Internal Governance Rules.

As part of that seminar, the LSB shared with Applicable Approved Regulators its thinking on the certificate which would form the basis of AARs' submissions under the dual self-certification process.

Having worked with the AARs to develop ideas, the LSB now publishes the following template certificate, which AARs should use when submitting their returns to the Board

**Regulatory Independence Certification**

**On behalf of [***insert name of AAR***], an approved regulator designated under section 20 and Schedule 4 of the Legal Services Act 2007, we jointly certify that we have in place arrangements that comply with the requirements of the Internal Governance Rules 2009 and that in particular:**

(1) observe and respect the principle that structures or persons with representative functions must not exert, or be permitted to exert, undue influence or control over the performance of regulatory functions, or any person(s) discharging those functions;

(2) ensure that persons involved in the exercise of our 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 Legal Services Board, the Consumer Panel, the OLC and other Approved Regulators;

(3) ensure that the exercise of our regulatory functions is not prejudiced by our representative functions or interests;

(4) ensure that the exercise of our regulatory functions is, so far as reasonably practicable, independent of our representative functions;

(5) ensure that such steps are taken as are reasonably practicable to ensure the provision of such resources as are reasonably required for or in connection with the exercise of our regulatory functions; and

(6) ensure that persons involved in the exercise of our regulatory functions are able to notify the Legal Services Board where they consider that their independence or effectiveness is being prejudiced.

**Signed:**

**Applicable Approved Regulator**

_____ and _____

**[***President/equivalent***]** **[***Chief Executive/equivalent***]**

**Regulatory board**

_____ and _____

**[***President/equivalent***]** **[***Chief Executive/equivalent***]**

**Principle 1**: Governance

| Internal Governance Rule | Relevant arrangements in place | Summary of those arrangements | Summary of practical issues that have arisen over [past year] in respect of these issues |
|---|---|---|---|
| **A.** Each AAR must delegate responsibility for performing all regulatory functions to a body or bodies without any representative functions. | [*AAR to cite relevant arrangements, such arrangements to be annexed in full to the certificate*] | [*AAR to summarise the meaning and effect of those arrangements*] | [*AAR to summarise any significant issues with the working of the arrangements and explain the extent to which they comply with the rule's requirements*] |
| **B.** The regulatory body or, if more than one, each of the regulatory bodies, must be governed by a board or equivalent structure | [*AAR to cite relevant arrangements, such arrangements to be annexed in full to the certificate*] | [*AAR to summarise the meaning and effect of those arrangements*] | [*AAR to summarise any significant issues with the working of the arrangements and explain the extent to which they comply with the rule's requirements*] |
| **C.** In appointing persons to regulatory boards, AARs must ensure that:<br>• a majority of members of the regulatory board are lay persons; and<br>• 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. | [*AAR to cite relevant arrangements, such arrangements to be annexed in full to the certificate*] | [*AAR to summarise the meaning and effect of those arrangements*] | [*AAR to summarise any significant issues with the working of the arrangements and explain the extent to which they comply with the rule's requirements*] |

| LSB Guidance | Extent to which guidance has been followed, with any reasons for departing from guidance explained |
|---|---|
| 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. | [*AAR to summarise the extent to which guidance has been followed*] |
| 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:<br>• ensure that it does not contradict or add material new requirements to any rules or guidance made by the regulatory body/bodies; and<br>• consult with the regulatory body/bodies when developing that guidance | [*AAR to summarise the extent to which guidance has been followed*] |

| **The Principle** | **Explanation of any other arrangements in place that bare on the principle and in particular how those arrangements comply with the principle** |
|---|---|
| Nothing in an Applicable Approved Regulator's (AAR's) arrangements should impair the independence or effectiveness of the performance of its regulatory functions | [*For AAR to complete*] |

**Principle 2**: Appointments etc

| Internal Governance Rule | Relevant arrangements in place | Summary of those arrangements | Summary of practical issues that have arisen over [past year] in respect of these issues |
|---|---|---|---|
| **A.** 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. | [*AAR to cite relevant arrangements, such arrangements to be annexed in full to the certificate*] | [*AAR to summarise the meaning and effect of those arrangements*] | [*AAR to summarise any significant issues with the working of the arrangements and explain the extent to which they comply with the rule's requirements*] |
| **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 the Schedule. | [*AAR to cite relevant arrangements, such arrangements to be annexed in full to the certificate*] | [*AAR to summarise the meaning and effect of those arrangements*] | [*AAR to summarise any significant issues with the working of the arrangements and explain the extent to which they comply with the rule's requirements*] |
| **C.** Decisions in respect of the remuneration, appraisal, reappointment and discipline of persons appointed to regulatory boards must respect the principle of regulatory independence and | [*AAR to cite relevant arrangements, such arrangements to be annexed in full to the certificate*] | [*AAR to summarise the meaning and effect of those arrangements*] | [*AAR to summarise any significant issues with the working of the arrangements and explain the extent to which they comply with the rule's requirements*] |

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| the principles relating to "appointments etc" set out in the Schedule. | | | |
| **D.** Except insofar as an AAR would be, or would reasonably be considered likely to be, exposed to any material legal liability (other than to pay wages, salaries etc) as a consequence of the delay required to obtain the concurrence of the Board, no person appointed to a regulatory board must be dismissed except with the concurrence of the Board. | [*AAR to cite relevant arrangements, such arrangements to be annexed in full to the certificate*] | [*AAR to summarise the meaning and effect of those arrangements*] | [*AAR to summarise any significant issues with the working of the arrangements and explain the extent to which they comply with the rule's requirements*] |
| **E.** No person appointed to and serving on a regulatory board must also be responsible for any representative function(s). | [*AAR to cite relevant arrangements, such arrangements to be annexed in full to the certificate*] | [*AAR to summarise the meaning and effect of those arrangements*] | [*AAR to summarise any significant issues with the working of the arrangements and explain the extent to which they comply with the rule's requirements*] |

| LSB Guidance | Extent to which guidance has been followed, with any reasons for departing from guidance explained |
|---|---|
| If regulatory boards do not lead on managing the appointments process, it should have a very strong involvement at all stages. | [*AAR to summarise the extent to which guidance has been followed*] |
| 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. | [*AAR to summarise the extent to which guidance has been followed]* |
| Appointment panels or equivalent should be established following the guidance set out in the Board's letter of 2 December 2008[32]. | [*AAR to summarise the extent to which guidance has been followed]* |
| 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). | [*AAR to summarise the extent to which guidance has been followed]* |
| The appointments process should be conducted with regard to the desirability of securing a diverse board with a broad | [*AAR to summarise the extent to which guidance has been followed]* |

[32] See: http://www.justice.gov.uk/news/docs/legal-services-board-open-letter-021208.pdf

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| range of skills. The framework applied at Schedule 1 paragraph 3 of the Act serves as a useful template. | |
| • Remuneration – decisions in respect of regulatory board pay and conditions should be made having regard to best practice and in any event should not be controlled wholly or mainly by persons responsible for representative functions;<br>• Appraisals – while persons with representative functions may be consulted about regulatory board members' appraisal, they should not be involved formally in agreeing the outcome, or future objectives;<br>• Reappointments – decisions should be guided by objective appraisals and the desirability of ensuring a balance between regular turnover and continuity. | [*AAR to summarise the extent to which guidance has been followed]* |
| While the LSB accepts that there may be exceptional reasons which justify immediate dismissal without concurrence having first been obtained, it would expect | [*AAR to summarise the extent to which guidance has been followed]* |

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| a full explanation if such circumstances were ever to arise. An AAR should accordingly be prepared to justify why it could not comply with the relevant Rule. | |
| Where an AAR proposes to discipline one or more member(s) of a regulatory board, where such discipline is short of dismissal, the Board should be consulted privately in advance of the action being taken, and the AAR should consider any representations the Board may chose to make. | [*AAR to summarise the extent to which guidance has been followed]* |
| Where possible, a person appointed should not have been responsible for any representative functions immediately prior to appointment.<br>The longer the gap between holding responsibility for representative functions and taking up regulatory functions, the more likely it is that the principle of regulatory independence will be observed. | [*AAR to summarise the extent to which guidance has been followed]* |
| Codes of conduct or equivalent for board members should highlight the importance of observing and respecting the regulatory objectives and the principles of better regulation, rather than operating to represent any one or more sectoral | [*AAR to summarise the extent to which guidance has been followed]* |

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| interests.<br>Codes should also highlight the importance of respecting the principle of regulatory independence, as underlined by the provisions of sections 29 and 30 of the Act. | |

| **The Principle** | **Explanation of any other arrangements in place that bare on the principle and in particular how those arrangements comply with the principle** |
|---|---|
| (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. | [*For AAR to complete*] |

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| (2) All persons appointed to regulatory boards must respect the duty to comply with the requirements of the Legal Services Act 2007. | |

**Principle 3**: Strategy and Resources etc

| Internal Governance Rule | Relevant arrangements in place | Summary of those arrangements | Summary of practical issues that have arisen over [past year] in respect of these issues |
|---|---|---|---|
| **A.** Defining and implementing a strategy should include:<br>• access to the financial and other resources reasonably required to meet the strategy it has adopted;<br>• effective control over the management of those resources; and<br>• the freedom to govern all internal processes and procedures. | [*AAR to cite relevant arrangements, such arrangements to be annexed in full to the certificate*] | [*AAR to summarise the meaning and effect of those arrangements*] | [*AAR to summarise any significant issues with the working of the arrangements and explain the extent to which they comply with the rule's requirements*] |
| **B.** The regulatory body (or each of the regulatory bodies) must have the power to do anything within its allocated budget calculated to facilitate, or incidental or conducive to, the carrying out of its functions. | [*AAR to cite relevant arrangements, such arrangements to be annexed in full to the certificate*] | [*AAR to summarise the meaning and effect of those arrangements*] | [*AAR to summarise any significant issues with the working of the arrangements and explain the extent to which they comply with the rule's requirements*] |

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| **C.** Insofar as provision of resources is concerned, arrangements must provide for transparent and fair budget approval mechanisms. | [*AAR to cite relevant arrangements, such arrangements to be annexed in full to the certificate*] | [*AAR to summarise the meaning and effect of those arrangements*] | [*AAR to summarise any significant issues with the working of the arrangements and explain the extent to which they comply with the rule's requirements*] |
| **D.** Insofar as provision of any non-financial resources is concerned (for example, services from a common corporate service provider, or staff), arrangements must provide for transparent and fair dispute resolution mechanisms. | [*AAR to cite relevant arrangements, such arrangements to be annexed in full to the certificate*] | [*AAR to summarise the meaning and effect of those arrangements*] | [*AAR to summarise any significant issues with the working of the arrangements and explain the extent to which they comply with the rule's requirements*] |

| **LSB Guidance** | **Extent to which guidance has been followed, with any reasons for departing from guidance explained** |
|---|---|
| The Act requires separation of regulatory and representative functions. Absent of corporate management structures that are robustly and demonstrably separated from the control of persons with representative functions, these Rules are likely to require a high degree of delegation to regulatory bodies in respect of the control of strategy and resourcing. | [*AAR to summarise the extent to which guidance has been followed*] |

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| What is or is not a regulatory function is determined in accordance with the Act. Subject to the Act, whether something is 'regulatory' should be for each regulatory body to determine, in close consultation with respective AARs. | [*AAR to summarise the extent to which guidance has been followed*] |
| Where members of staff are employed by an AAR to discharge regulatory functions under the delegated remit of a regulatory body, the position of the AAR as legal employer should be recognised in the arrangements made under these rules. However, in complying with these Rules, those arrangements should make clear how decisions with respect to the management and control of such members of staff are to be exercised.<br>The presumption under such arrangements should be – subject only to being exposed to unreasonable liability (such as in creating a pension scheme) – that an AAR should always agree a reasonable request from its regulatory body. While an AAR has a right of veto, therefore, it also carries a responsibility to justify that decision in light of the principle of regulatory independence. | [*AAR to summarise the extent to which guidance has been followed*] |

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| The Board may from time to time issue further illustrative guidance on these issues under Rule 11 of these Rules. | |
| Each regulatory body should act reasonably when defining and implementing its strategy, and should in particular have regard to the provisions of Section 28 of the Act. It should also have due regard to the position of the AAR and in particular to any responsibilities or liabilities it may have as AAR. | [*AAR to summarise the extent to which guidance has been followed*] |
| Each regulatory body should act reasonably when exercising its functions in accordance with this Rule, and should in particular have regard to the provisions of Section 28 of the Act. It should also have due regard to the position of the AAR and in particular to any responsibilities or liabilities it may have as AAR. | [*AAR to summarise the extent to which guidance has been followed*] |
| The process established by the AAR should provide appropriate checks and balances between it and the regulatory body (or bodies) so as to ensure value for money and observe the wider requirements of the Act, without impairing the independence or effectiveness of the | [*AAR to summarise the extent to which guidance has been followed*] |

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| regulatory body (or bodies). | |
| Subject only to the formal budgetary approval process and the operation of its dispute resolution mechanism(s) , an AAR's arrangements should not prevent those performing regulatory functions, where they believe their independence and/or effectiveness is compromised or prejudiced, from obtaining required services otherwise than through the AAR. | [*AAR to summarise the extent to which guidance has been followed*] |
| AARs and regulatory bodies should be particularly careful to ensure that, in respect of public and/or consumer-facing services (including media relations and marketing-type activities), the principle of regulatory independence should be seen to be met, as well as being met. | [*AAR to summarise the extent to which guidance has been followed*] |
| When considering whether arrangements meet the required standards, the Board will consider factors such as:<br>• evidence that the provision of services to the regulatory body (or bodies) is not subordinate to the provision of services to any other part of the AAR;<br>• provision being made for service level | [*AAR to summarise the extent to which guidance has been followed*] |

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| agreements agreed between respective parties; and<br>• transparent, fair and effective dispute resolution mechanisms being in place. | |

| **The Principle** | **Explanation of any other arrangements in place that bare on the principle and in particular how those arrangements comply with the principle** |
|---|---|
| Subject only to the oversight permitted under Part 4 of this Schedule, persons performing regulatory functions must have the freedom to define a strategy for the performance of those functions and work to implement that strategy independently of representative control or undue influence. | [*For AAR to complete*] |

**Principle 4**: Oversight etc

| **Internal Governance Rule** | **Relevant arrangements in place** | **Summary of those arrangements** | **Summary of practical issues that have arisen over [past year] in respect of these issues** |
|---|---|---|---|
| **A.** Arrangements in place must be transparent and proportionate. | [*AAR to cite relevant arrangements, such arrangements to be annexed in full to the certificate*] | [*AAR to summarise the meaning and effect of those arrangements*] | [*AAR to summarise any significant issues with the working of the arrangements and explain the extent to which they comply with the rule's requirements*] |
| **B.** Arrangements in place must prohibit intervention, or the making of directions, in respect of the management or performance of regulatory functions unless with the concurrence of the Board. | [*AAR to cite relevant arrangements, such arrangements to be annexed in full to the certificate*] | [*AAR to summarise the meaning and effect of those arrangements*] | [*AAR to summarise any significant issues with the working of the arrangements and explain the extent to which they comply with the rule's requirements*] |

| **LSB Guidance** | **Extent to which guidance has been followed, with any reasons for departing from guidance explained** |
|---|---|
| In making its arrangements, an AAR should balance its ultimate responsibility for the discharge of regulatory functions with its responsibilities to ensure separation of regulatory and representative functions. | [*AAR to summarise the extent to which guidance has been followed*] |

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| In considering proportionality, AARs should consider the risk of Board intervention. Note the Board's policy statement on compliance and enforcement powers, and in particular the Board's intention to use its most interventionist powers only when other measures (including informal measures) have failed. | [*AAR to summarise the extent to which guidance has been followed*] |
| In determining whether to give concurrence, the Board will consider the extent to which the process leading to the proposed intervention or directions complies with the principle of regulatory independence. | [*AAR to summarise the extent to which guidance has been followed*] |

| **The Principle** | **Explanation of any other arrangements in place that bare on the principle and in particular how those arrangements comply with the principle** |
|---|---|
| Oversight and monitoring by the AAR (which is ultimately responsible and accountable for the discharge of its regulatory functions) of persons performing its regulatory functions must not impair the independence or effectiveness of the performance of those functions. | [*For AAR to complete*] |

## General Evaluation

| **The Approved Regulator** |
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| [*Opportunity for AR to give overall commentary on operation of arrangements during the past year*] |

| **The Regulatory Body** |
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| [*Opportunity for AR to give overall commentary on operation of arrangements during the past year*] |