LEGAL SERVICES BOARD

Reviewing the Internal Governance Rules

Enhancing regulatory independence within the current legislative framework

This consultation will close on 9 February 2018

This Consultation Paper will be of interest to:

Approved Regulators

Providers of Legal Services

Legal Representative Bodies

Legal Advisory Organisations

Other Third Sector Organisations

NDPBs

Consumer Groups

Law Schools/Universities

Legal Academics

Members of the Legal Profession

Accountancy Bodies

Potential new entrants to the ABS market

Think Tanks

Political Parties

Government Departments

Executive summary

Independent regulation gives confidence to consumers, providers, investors and society as a whole that legal services work in the public interest and support the rule of law.

The Legal Services Act 2007 (the Act) does not create a framework in which all regulatory bodies are structurally separate from representative bodies. Rather, the Act requires the Legal Services Board (LSB) to make Internal Governance Rules (IGR) which set out requirements that approved regulators (ARs) must meet to ensure the independent exercise of regulatory functions. The IGR first came into force in 2010 and were subsequently amended in part in 2014.

The purpose of this consultation document is to explore whether changes are needed to the IGR to enhance regulatory independence. The Act does not allow the LSB to require structural or legal separation of representative and regulatory functions. A review of the legislative framework by government for the regulation of legal services appears to be, unlikely for the time being. We are therefore interested to understand stakeholders experiences of operating under the current IGR, including whether the IGR might be improved within the constraints of the Act and, if so, how.

This document explains that the evidence we have obtained to date suggests there are issues with the current IGR. This includes the steady stream of disagreements about independence matters that have been raised with the LSB since 2010. Many of these issues appear to stem from a lack of shared understanding about what residual functions remain with an AR where it has delegated the discharge of its regulatory functions to another body. There is also evidence of dissatisfaction with the exclusion of certain ARs from some of the more detailed obligations set out in the Schedule to the IGR.

We have considered two high-level options to help us develop our thinking on the future of the IGR. These are:

- no change to the current IGR, but potentially with increased assurance and LSB enforcement activity

- amend the IGR, with a number of possible sub-options that might involve incremental through to extensive amounts of change and/or prescription.

We have also set out some initial thoughts on how the LSB might gain assurance on compliance by ARs with the IGR (regardless of whether they are amended as a consequence of this consultation). Options could include re-starting self-certification of compliance by the ARs and their regulatory bodies (which was in place between 2010 and 2013), third party assurance and/or incorporating IGR compliance into our regulatory performance assessments.

The consultation will close at 5pm on Friday 9 February 2018.

Introduction

About the Legal Services Board

1. The LSB is the independent body that oversees the regulation of legal services in England and Wales. We were created by the Act.

2. We hold to account regulators for the different branches of the legal services profession and the Office for Legal Complaints, which administers the Legal Ombudsman scheme. Where improvement is needed, we drive change in pursuit of a modern and effective legal services sector: one that better meets the needs of consumers, citizens and practitioners.

3. We want to see a legal services market that is characterised by a regulatory framework that commands the trust and confidence of consumers, the public and all those with an interest in legal services.

4. The legal services sector:

    - is central to the maintenance of our democratic system. The rule of law and access to justice are fundamental pillars of democracy

    - underpins the operation of English and Welsh law, which in turn supports all economic activity including the growth and development of new businesses

    - employs 320,000 people and has an annual turnover of over £32 billion, and is of major economic importance in its own right.

Regulatory independence

5. We believe that regulation should ideally be structurally, legally and culturally independent of the professions and government, as explained in our September 2016 document: 'Vision for legislative reform of the regulatory framework'.[1] This is important in delivering confidence:

    - to consumers who use legal services (in an environment in which most are unable to judge for themselves the value or quality of what is being provided), that their interests will not be overridden by professional or commercial interests

    - to providers and investors to grow their businesses and innovate without fear that politically-motivated interventions or the interests of incumbent providers will undermine their investments

    - to society more broadly, that regulation affecting vital public interest outcomes such as the rule of law is transparent, accountable,

[1] http://www.legalservicesboard.org.uk/news_publications/LSB_News/PDF/2016/20160909LSB_Vision_For_Legislative_Reform.pdf

proportionate and consistent, and is targeted only at cases in which action is needed.

6. The Act sets out regulatory objectives[2] which the LSB and the ARs must have regard to in carrying out their statutory functions. Independent regulation supports most directly the regulatory objectives of:

    - protecting and promoting the public interest
    - supporting the constitutional principle of the rule of law
    - protecting and promoting the interests of consumers
    - encouraging an independent, strong, diverse and effective legal profession (in that - amongst other things - regulation must be independent of government so that it cannot be used as a route for government interference with the independence of lawyers).

7. The Act does not create a framework in which all regulatory bodies are structurally separate from representative bodies. Rather, it creates ARs[3] which may have both representative and regulatory functions. The Act then gives the LSB responsibility for their oversight,[4] but only in relation to regulation.[5] Our responsibilities include a duty to make IGR,[6] setting out requirements ARs must meet to ensure the independent exercise of regulatory functions.

8. The IGR have specifically (and perhaps quite narrowly) defined the principle of regulatory independence. The definition states that structures or persons with representative functions must not exert, or be permitted to exert, undue influence[7] or control over regulatory functions. Independence in this sense is more than just structures. It includes ensuring that those responsible for regulatory functions are not consciously or unconsciously influenced. However, as explained in more detail in Annex A, the Act does not allow us to require structural or legal separation of representative and regulatory functions (although this is what some ARs may choose to do). Further details of the legal context for the LSB's work on regulatory independence are also set out in Annex A.

[2] Section 1 of the Act
[3] On commencement of part 1 of Schedule 4 to the Act, or as a consequence of designation by order of the Lord Chancellor, following a recommendation by the LSB.
[4] Part 4 of the Act.
[5] Section 29 of the Act.
[6] Section 30 of the Act.
[7] Undue influence is defined in the IGR as: *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.*

The internal governance rules and applicable approved regulators

9. Putting in place IGR to advance regulatory independence was one of the LSB's first priorities on being established. The importance of independence in legal services is undiminished.

10. A timeline of the evolution of the IGR framework, including LSB consultations and response documents, is at Annex C. The current IGR are at Annex D.[8] ARs have made some good progress in the intervening period in putting in place revised arrangements to ensure that regulation is not prejudiced by representative interests. However, as we discuss in more detail below, in our view a review of the IGR is now timely. This is because the IGR have not been reviewed in full since they were first introduced more than seven years ago. We also note (amongst other things) evidence of on-going and significant disagreements about independence matters between ARs and regulatory bodies and the possible inefficient duplication of oversight of regulation between ARs and the LSB.

11. The IGR set out general requirements that apply to all ARs, plus a schedule of more detailed requirements that apply only to 'applicable approved regulators' (AARs). AARs are ARs that satisfy both of the following conditions:

    - they are responsible for the discharge of both regulatory *and* representative functions in relation to legal activities

    - they regulate persons whose primary reason to be regulated by that AR is those persons' qualifications to practise a reserved legal activity that is regulated by that AR.

12. Currently:

    - the AARs are the Law Society, the Bar Council, the Chartered Institute of Legal Executives, the Chartered Institute of Trademark Attorneys, the Chartered Institute of Patent Attorneys and the Association of Costs Lawyers

    - the Council of Licensed Conveyancers and the Master of the Faculties are ARs but not AARs (because they only discharge regulatory functions) and the Institute of Chartered Accountants in England and Wales (ICAEW) is an AR but not an AAR (because it regulates persons whose primary reason to be regulated by the ICAEW is accountancy services)

    - in addition there are two ARs that are not AARs and that are not presently active in the legal services market: the Institute of Chartered Accountants of Scotland (ICAS) and the Association of Chartered Certified Accountants (ACCA).

[8] http://www.legalservicesboard.org.uk/what_we_do/regulation/pdf/Internal_Governance_Rules_Version%203_Final.pdf

The purpose of this paper

13. Working within the constraints created by the Act, as discussed at paragraph 8 and Annex A, this consultation seeks to explore whether changes are needed to the IGR to enhance regulatory independence. We are interested to understand stakeholders' experiences of operating under the IGR, including whether they might be improved and, if so, how.

14. In particular, views are sought on different options for enhancing regulatory independence through the IGR. In summary, these are:

    a. no change to the current IGR, but potentially with increased assurance and LSB enforcement activity

    b. amend the IGR, with a number of possible sub-options that might involve increasing amounts of change and/or prescription.

15. We welcome views and evidence from stakeholders on these options and the issues discussed in this paper.

Why we are publishing this consultation now

16. The current IGR have not been reviewed in full since they were first introduced at the end of 2009.[9] This means that they may not give consideration to relevant developments, for example the increased emphasis across the economy on corporate transparency.

17. We now have several years of experience of how the IGR are working in practice. This includes through (i) our assessment of AAR arrangements for complying with the IGR, (ii) dealing with ad-hoc issues and independence related disagreements brought to our attention (which are discussed in more detail at paragraph 21), and (iii) feedback from ARs and regulatory bodies. In particular, that feedback includes calls for the IGR to provide more clarity on the oversight role of the AAR in respect of its regulatory body. This experience may suggest that the IGR are not as effective as they could be.

18. Although the LSB and other bodies have called for a review of the legislative framework for the regulation of legal services,[10] with a view to increasing regulatory independence, this appears unlikely for the time being.[11] In addition, following its recent tailored review of the LSB, the Ministry of Justice recommended that:

[9] A partial review of the IGR – in relation to appointments and chairing arrangements – was carried out and amendments made in 2014.

[10] In November 2015, HM Treasury announced in its competition plan that the government would consult in spring 2016 on making legal service regulators independent from their representative bodies and in 2016 the Competition and Markets Authority (CMA) legal services market study final report identified a number of issues arising from the current regulatory structure. The CMA considered that regulatory independence from providers and government is a fundamental principle for the regulatory framework and consequently the CMA recommended the government should undertake a review of regulatory independence as a priority.

[11] Accordingly, the LSB business plan for 2017/18 said that we would begin a review of the IGR to consider if changes are required.

"*To ensure continued public and international confidence in the regulation of the legal sector, the LSB should use all of its powers to provide robust assurance on the separation of the frontline regulators from the representative functions of the Approved Regulators, including the use of its investigative powers where appropriate. Any changes, including those as a result of the review of internal governance rules, should be made within the existing legislative framework*."[12]

19. More recently, in his decision not to extend the designation of the ICAEW as an AR and a licensing authority, the Lord Chancellor questioned the ICAEW's arrangements for regulatory independence.[13]

20. This consultation responds to these points by exploring options within the existing legislative framework for amending the IGR to enhance regulatory independence. It is wholly separate to the on-going LSB investigation of governance arrangements between the Law Society and Solicitors Regulation Authority (SRA) (which is focused on past events under the current IGR). However, the Law Society/SRA investigation will in due course offer a source of evidence additional to those discussed above, which we will take into account in this review of the IGR when it is concluded.

[12] Tailored Reviews of the Legal Services Board and Office for Legal Complaints: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/630084/lsb-olc-tailored-review-2017.pdf
[13] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/646508/decision-notice-lord-chancellor-to-mr-izza-21-sept-2017.PDF

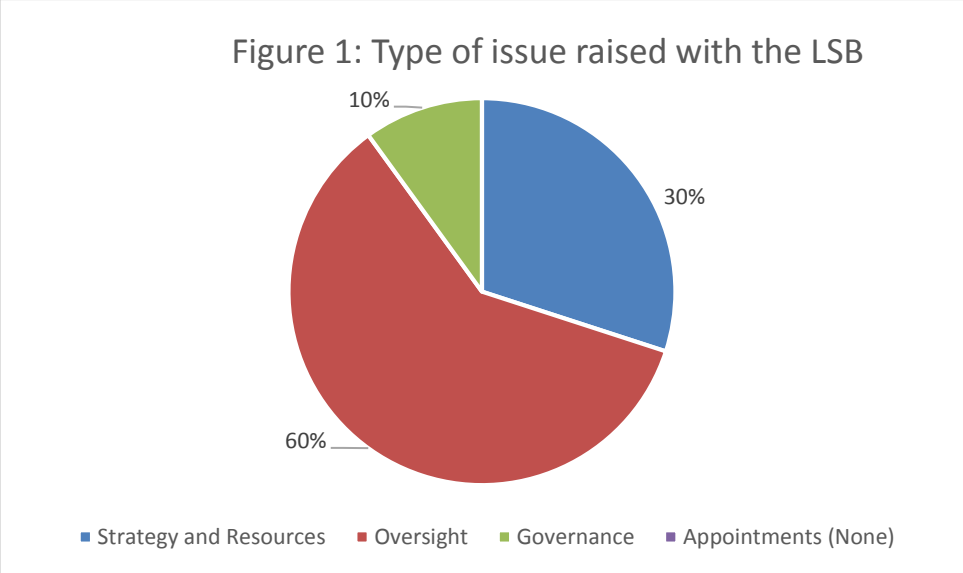
Issues with the current IGR

'Ad-hoc' independence issues

21. The current IGR are included at Annex D. ARs have raised concerns with the LSB, including in discussions leading up to this consultation, about the IGR that span all four key areas covered in the Schedule to the IGR, namely:[14]

    - governance
    - appointments
    - strategy and resources
    - oversight.

    The number and severity of ad-hoc independence issues that have been shared with the LSB has remained significant and relatively steady over time. The following chart provides a high-level breakdown of the 30 issues that ARs and regulatory bodies have raised in correspondence with us following the last time the IGR were changed in April 2014:[15]



22. These issues have been raised by a range of different ARs and regulatory bodies with no one organisation (nor a particular AAR/regulatory body combination) being the primary source of independence issues.

23. We invited ARs and regulatory bodies to share informally their practical experience of the IGR as part of the initial scoping of this review. A range of views were expressed in those discussions, although some broad themes emerged, as outlined below.

[14] Schedule to the IGR: Principles
[15] The 30 issues were identified from written correspondence to the LSB since 2015 and excludes correspondence in relation to the LSB's two investigations: http://www.legalservicesboard.org.uk/what_we_do/investigations.htm

24. A majority of the stakeholders raised the issue of legal structures and the formal agreements that they had in place. In summary:

    - a number of the regulatory bodies that we spoke to said there is a need for full legal separation between representative and regulatory functions (which is discussed at paragraph 8 above). Full legal separation is opposed by some ARs

    - there were calls from a number of ARs and a majority of regulatory bodies for the language in the IGR to be clearer, and for more clarity also around the residual role of the AAR once regulatory functions are delegated

    - we heard from several of the regulatory bodies that it would be useful to review the AAR definition, while some ARs believed that this was not needed.

25. The information in Figure 1 (based on analysis of ad-hoc independence issues raised with the LSB since 2014) means it is unsurprising that the ways in which assurance is sought by AARs (and the LSB) was a central theme in our recent discussions:

    - the majority of those we spoke to considered that cultural issues and personalities played a large part in the relationship between AARs and regulatory bodies

    - most of the AARs and regulatory bodies have agreements in place on how interaction will occur between representative and regulatory functions. We also heard that sometimes these agreements were not followed

    - nearly all of the AARs reported that they needed certain information from their regulatory bodies to undertake their assurance role (which was not always forthcoming), while a number of regulatory bodies considered that, at times, this was disproportionate or unduly tied up limited management resources

    - some of the regulatory bodies were of the view that their representative bodies had too much influence on board level appointments

    - there was concern from quite a few of the regulatory bodies that having to seek budget approval from AARs, and the process for doing so, unduly curtailed regulatory functions

    - there was common awareness that there will continue to be issues no matter how the IGR are drafted, given the inherent tension created by the legal framework in the Act.

26. From representations made to us, and from our own experience of disputes about independence, many issues appear to stem from a lack of shared

understanding about what residual functions remain with an AAR once it has delegated the discharge of its regulatory functions to another body, i.e. its regulatory body. In particular, there is disagreement about what oversight the AAR should exercise over its regulatory body.

27. Most of the ARs and regulatory bodies have told us that the IGR are not as effective as they could be. The current drafting is indicative of what could be termed an expansive approach, i.e. an AAR can do anything so long as independence is not compromised. This approach reflected the preference at the time the IGR were first drafted for AARs and regulatory bodies to have the opportunity to secure regulatory independence constructively.

28. Views shared with us include concerns that the language of the IGR is qualified, open to interpretation and difficult to apply in practice. Stakeholders have told us that this contributes to continuing disagreement about what is and is not permitted and have expressed a desire for greater clarity on what oversight by an AAR is legitimate.

29. Practical consequences of disagreements on independence include AAR, regulatory body and LSB management time and resources spent dealing with tensions around independence. This detracts from matters which could allow respective parties to deliver improvements for consumers, the profession and the public. For some regulators, this is said to consume a significant portion of their available resources. We have been told by regulatory bodies that there may also be an anticipatory chilling effect on reform of regulation, where policies are diluted or not pursued, in the knowledge that these will be contentious and/or that it will be disproportionately resource-intensive to deliver change.

30. Public discussion between AARs and their regulatory bodies about independence is occasionally robust. This is perceived by some as harmful to the reputation of the legal sector as a whole.

31. Following the introduction of the IGR, the LSB was relatively heavily involved in mediating between AARs and their regulatory bodies, while extensive changes were made to structures and governance arrangements with the aim of securing regulatory independence. Given progress made, and in keeping with our regulatory approach, we are not now typically involved to the same degree. This reflects our original expectation that 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'*.[16]

32. The confidential basis on which the LSB and stakeholders have discussed regulatory independence and the IGR limits what we are able to say in this

[16] http://www.legalservicesboard.org.uk/what_we_do/consultations/closed/pdf/response_lsb_101209_2.pdf

consultation. To help us develop a clear evidence base to inform next steps for the IGR, detailed discussion of your experience of these points will be helpful.

Question 1: We welcome evidence on (i) the general nature, frequency and impact of disagreements on regulatory independence matters, and (ii) how the IGR are used and their effectiveness in moderating such disagreements.

The definition of AAR

33. Some stakeholders are dissatisfied with the exclusion of certain ARs with both representative and regulatory functions from the more detailed obligations that are set out in the Schedule to the IGR. This exclusion is a consequence of the drafting of the definition of AAR in the IGR (see paragraph 65). Stakeholders have expressed concern that this results in an inconsistent regulatory burden. Since the regulatory burden is ultimately borne by regulated persons,[17] any inconsistencies in that burden may adversely affect competition between them.

Investigations of possible breaches of the IGR

34. Since we first introduced the IGR at the beginning of 2010, the LSB has initiated two investigations into possible breaches of them. These investigations have been resource intensive for the LSB, as well as for the AARs and regulatory bodies concerned. One investigation concluded that there had in fact been a breach of the IGR,[18] while the other is on-going. We recognise that some stakeholders would welcome our further intervention in ad-hoc independence issues. An increase in intervention might be a route open to the LSB, but it would have resource implications. We welcome stakeholders' views on this.

Possible duplication of oversight

35. AARs do not always appear to take account of the oversight role of the LSB when framing their own oversight requirements for their regulatory bodies. This includes our work on assessing practising fees, rule change applications and regulatory performance. This has the potential to lead to the duplication of work for regulatory bodies. This is because, while the AAR may need assurance on some of the same matters as the LSB and may need assurance at a different point in time from the LSB, there should be scope for the AAR to gain this assurance (at least in part) by building on the LSB's work rather than replicating it. Stakeholders have encouraged the LSB to restate the work we do in assessing and overseeing the performance of the regulatory bodies, with a view to this giving reassurance to AARs. We have done this in Annex B. Increased clarity - whether through the IGR or otherwise - around the residual role of an AAR when it has delegated its regulatory functions could also help address this issue.

Assurance of compliance: dual self-certification

36. Initially the LSB had required all AARs and their regulatory bodies to undertake dual self-certification (DSC) to provide assurance of compliance with the IGR.

[17] Defined in section 176 of the Act.
[18] http://www.legalservicesboard.org.uk/Projects/pdf/LSB_investigation_into_bar_council_influencing_of_the_BSB_(25-11-13).pdf

The DSC process, and why the LSB has not required this since 2013, is discussed in more detail in paragraph 86. The number of issues brought to us has not varied much between the period when we required DSC and now. How assurance on compliance with the IGR might be sought going forward is discussed at paragraph 83.

Options for the future of the IGR

37. We have considered two high-level options to help us develop our thinking on the future of the IGR. These are:

    1) no change to the current IGR, but potentially with increased assurance and LSB enforcement activity

    2) amend the IGR, with a number of possible sub-options that might involve incremental through to extensive amounts of change and/or prescription.

38. To inform our thinking on these options, we welcome views and evidence on which elements of the IGR work well and which could be improved. We also welcome alternative suggestions as to how the IGR might be developed to enhance regulatory independence, in keeping with the regulatory framework. As explained in more detail in Annex A, the Act does not allow us to require structural or legal separation of representative and regulatory functions (although this is what ARs may choose to do), so we have not included this in our list of options to explore as part of this consultation process.

39. In the event that we decide to amend the IGR, we will consult further on any new drafting. This reflects that we are not consulting on specific amendments to the IGR in this document.

40. As we explore the options below, we will consider how the proposed course of action may affect the current regulatory arrangements and situation. We invite you to consider whether there are additional benefits or risks that we have not identified and if you have a preferred view on how the IGR should work.

41. We have laid out a summary of the options in Table 1 on the next page that we are seeking your views on.

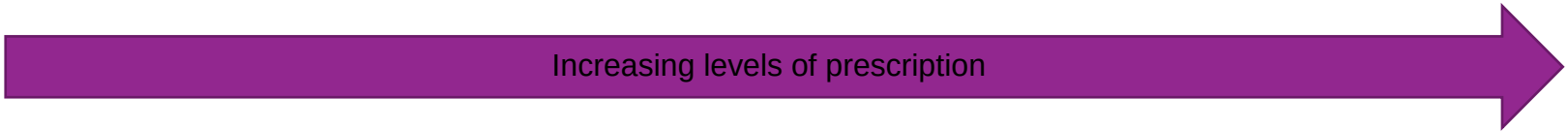


Table 1: Options on the future of IGR			
1. No change to the IGR	2a. Incremental changes	2b. More extensive changes	2c. A new approach
Key features: • Continue to use the existing IGR framework: i.e. general obligations and a Schedule of principles, rules and guidance	Key features: • Continue to use the existing IGR framework • Minor changes to the Schedule to the IGR	Key features: • Extensive changes to the existing IGR framework • New obligations in the Schedule to the IGR	Key features: • Develop a new IGR framework • 'Gateways' for AR/regulatory body information flow and assurance
Possible changes: • More transparency on a voluntary basis by regulatory bodies • LSB facilitates discussions between ARs and regulatory bodies • Increased frequency of assurance work • Increased awareness of LSB oversight role and its implications	Possible changes: • Modify obligations in the Schedule to the IGR to address identified issues through additional clarity • Modify the presentation of the Schedule to the IGR to reflect other rules made by the LSB	Possible changes: • Review definitions in the IGR, e.g. 'regulatory independence' and 'AAR' • Review which AR the Schedule to the IGR should apply to • New obligations in the Schedule to the IGR to address identified issues	Possible changes: • Prescribed transparency by regulatory bodies • Prescribed information and assurance gateways identified for ARs and regulatory bodies • Possible identification/use of benchmarks from other sectors

Option 1: no change to the IGR

42. As noted above, there is now more than seven years' experience of the IGR. On one hand, it could be argued that they have been reasonably effective, given the low level of enforcement action taken by the LSB. Continued use of the IGR as they stand, could be argued to provide the greatest regulatory certainty relative to the uncertainty associated with making and implementing amendments to the rules. This would also maintain an outcomes-focused approach.

43. This approach would not, however, address the views discussed above, that the language used in the current IGR is unhelpfully qualified and open to interpretation. Evidence of on-going disputes between AARs and their regulatory bodies may suggest that the current IGR generate rather than reduce regulatory uncertainty. This has the potential to harm public confidence in the independence of regulation. Equally, this approach would not address the views noted above of the Competition and Markets Authority and the Ministry of Justice at paragraph 18 on regulatory independence.

44. It would be helpful to understand better the costs and benefits for stakeholders of the IGR in their current format. This includes the extent to which AARs may be able to reduce unnecessary duplication of the LSB's oversight role without any changes to the IGR. While there is evidence of issues associated with the IGR, as discussed above, we note that the regulatory framework means that some degree of tension is inevitable. To an extent, this may be desirable. The need for IGR to be applied in any form means that we should not expect to eradicate disagreement between AARs and regulatory bodies entirely.

45. No change to the IGR, however, would not necessarily preclude AARs and regulatory bodies embracing changes that could help to mitigate tensions. For example, it would be helpful to understand to what extent the need for interaction between AARs and regulatory bodies could be reduced, and the legitimate need for information by each organisation satisfied, as a consequence of increased transparency. Whether transparency might benefit from being captured in the IGR is discussed later.

46. Options for how LSB and public assurance on compliance might be achieved, including once any changes are implemented to the IGR, are discussed at paragraph 83. We are aware of calls from some stakeholders for greater intervention by the LSB, including in AAR-regulatory body disputes. Again, this is not dependent on amending the IGR. Whether this would be welcomed in practice and its effectiveness, including relative to the opportunity cost associated with the likely resources involved, is unclear.

47. LSB intervention could take a number of different forms. The following list includes areas in which we have been told that the LSB could offer assistance or more focused work:

- LSB acting to facilitate discussions
- increasing the frequency with which the LSB assures itself on compliance with the IGR
- giving reminders of our role, and indications of when we think that duplication by an AAR of our oversight role has occurred or may occur.

48. Some stakeholders have called for the LSB to commit to facilitating discussions between AARs and regulatory bodies when there are regulatory independence issues. We are aware that, in recent years, the number and severity of ad-hoc independence issues shared with the LSB has remained relatively steady. The impact that our involvement (or an alternative neutral mediation service) might have is unclear. It could, for example, result in greater initial effort by AARs and regulatory bodies to resolve matters and/or speedier resolution. Without change to the IGR, any facilitation may be voluntary and non-binding. The impact on the LSB's ability to undertake enforcement around possible breaches of the IGR, where it has earlier facilitated discussions, would also need to be considered, as the LSB must not fetter its discretion to use its enforcement powers if needed.

49. Currently, the scale of the LSB is such that devoting additional resources to dealing with ad-hoc independence issues would necessitate us carefully considering what activities we prioritise. One possibility might be for the LSB to seek an increase in the levy that it imposes on the profession, in order to fund expansion of these activities without having to reprioritise other work. We welcome stakeholders' views on this possibility.

50. Our ongoing regulatory performance assurance work is explained at Annex B. At paragraph 47, we discuss increasing the frequency with which the LSB assures itself on compliance with the IGR. One way that we might do that is through our regulatory performance assessments, which could allow focus and public commentary on regulatory independence. As discussed above, this would necessitate the LSB considering the extent of its resources and how best to allocate them.

51. Our broader oversight role is also discussed at Annex B. Reminders of this role might be communicated to AARs on an ad-hoc basis and/or as part of our regulatory performance assurance work. We might anticipate some robust exchanges, given views expressed previously by stakeholders on the LSB role. However, this would appear to be less resource intensive than the two suggestions discussed above. It may perhaps also have more practical effect in the medium to longer term on diminishing avoidable duplication of oversight by AARs and, in turn, reducing AAR-regulatory body disputes.

Question 2: What are the benefits and costs to stakeholders of operating under the existing IGR framework?

Question 3: Do you agree with option 1: no change to the IGR? Why or why not?

Question 4: What information do AARs need to receive from their regulatory body, and why? To what extent can these needs be met through transparency (and vice versa), thereby removing the need for further engagement?

Question 5: Do you want more intervention by the LSB in disputes between AARs and regulatory bodies? If so, what form should this intervention take?

Option 2: amend the IGR

52. Some stakeholders have requested changes to the IGR relating to the provision of additional detail or the addition of unequivocal obligations. Practically speaking, this would be likely to involve more prescription in the rules.

53. Additional prescription is not necessarily a problem. This may be appropriate if we are content, in light of the evidence arising from this review, that our current approach is not satisfactorily securing regulatory independence.

54. Broadly speaking, the three sub-options that we suggest for amending the IGR range from specific modifications and additions to the existing content and framework, through to adopting a new approach. These options are on a spectrum from less to more prescription. We have outlined a summary of all the options previously in Table 1.

Option 2a: incremental change

55. As discussed above, we have been told by ARs and regulatory bodies that the IGR are not as effective as they might be. We have heard suggestions for some incremental improvements. This may suggest that the high-level structure of the IGR (with general rules for all ARs and the Schedule of more detailed requirements for AARs) continues to be broadly fit for purpose, in that the more detailed obligations in the Schedule are appropriately targeted at AARs, in relation to which the risk to regulatory independence is greatest.

56. Option 2a might involve making minor changes to address perceived gaps and/or defects in the IGR. Overall, though, it could be relatively limited in scope. Working within the existing format of a separate Schedule to the IGR that applies to AARs (containing principles, rules and guidance), it might consist of:

    - modifying existing obligations with a view to providing additional clarity and/or refocussing obligations to address known issues. For example, we have heard a suggestion that provisions relating to the appointment and

reappointment of regulatory chairs[19] be extended to regulatory board members

- modifying the presentation of the Schedule, which we understand is perceived as difficult to follow, for example to reflect more closely the format of other LSB rules (i.e. move away from the use of columns within a table).[20]

57. Our initial view is that the four principles specified in the Schedule to the IGR, relating to governance, appointments, strategy and resources and oversight, remain helpful headings under which to marshal IGR requirements. However, views are welcomed on this point.

58. We are therefore interested in views on the merits of making minor changes to the IGR and, more specifically, what these might be. Limiting the extent of change has the potential to deliver benefits, while minimising the associated cost of implementing them. To an extent, this may maintain regulatory continuity. It is possible, however, that this might not secure the best possible outcome in terms of minimising AAR-regulatory body disagreements. To inform our assessment of this option, it would be helpful if stakeholders would explain what they anticipate the impact (including associated benefits and costs) would be of making any changes they propose to the IGR. This includes the extent to which this approach might reduce the frequency and severity of AAR-regulatory body disagreements associated with regulatory independence.

Question 6: Do you agree with option 2a: making incremental changes to the IGR? Why or why not?

Question 7: What incremental changes should the LSB prioritise, and why?

Question 8: What do you anticipate the impact of your proposed change(s) would be, and why?

Option 2b: more extensive change within the current IGR framework

59. Moving beyond incremental change, we have heard from stakeholders that additional obligations are needed in the IGR to enhance regulatory independence. Depending on how these are framed, they could either remain in keeping with an outcomes-focussed approach or they could potentially increase the level of prescription in the rules. Discussion to date appears to suggest that stakeholders' preference is for the latter.

60. Option 2b offers an opportunity to review how the current framework might be used best. Two possible elements (which are not mutually exclusive) might be:

[19] Part 2 C of the Schedule to the IGR: *'The process and decisions on appointments and reappointments of regulatory chairs should be delegated to an independent appointment panel or equivalent'*.
[20] The current tabular format is atypical of our approach to rules more generally. The LSB rules for Approved Regulator and Qualifying Regulator designation and Rules for Licensing Authority Designation Applications might, for example, offer an alternative format in which rules are set out and are followed by guidance.

- introducing new obligations in the Schedule to the IGR

- a review of definitions in the IGR, for example, the definition of AAR, and how that is applied, and the definition of regulatory independence.

New obligations

61. Suggestions from stakeholders for new obligations have included:

    - separate invoices for the non-regulatory and the regulatory components of the annual practising fee. Alternatively, a breakdown within a single invoice of how the practising fee is to be divided between the AAR and the regulatory body

    - a regulatory body being entitled to make, and its AAR being required to give reasonable consideration to, the case for commissioning services that may currently be shared with the AAR from a third party.

62. For the most part, these suggestions appear related to the desire among stakeholders more closely to define the residual role of the AAR, i.e. what control or oversight it is entitled to exercise over the regulatory body. Specific requirements related to transparency could be set out in the IGR to help address tensions between AARs and regulatory bodies (see the discussion of transparency at paragraph 45 above) rather than relying on transparency being achieved on a voluntary basis.

63. Option 2b would provide more opportunity to incorporate developments in best regulatory practice into the IGR. It could mitigate, to an extent, the level of AAR-regulatory body disagreements and could increase public confidence in the independence of legal services regulation. However, introducing more detailed rules may risk creating an incomplete list of obligations that needs to be constantly updated. More extensive changes to the IGR could also involve more resources or cost for AARs and regulatory bodies to change their regulatory arrangements to comply with the new requirements. This will, of course, depend on the obligations proposed.

The AAR definition

64. Alternative approaches to the AAR definition might include:

    (i) tailored agreements between the LSB and each AAR (for example, akin to the arrangements of regulators that may be comparable to the LSB, such as the Financial Reporting Council's approach to its regulated community)

    (ii) reviewing the exclusion from the AAR definition of ARs (such as ICAEW, ACCA and ICAS) that do not regulate persons whose primary reason to be regulated by that AR is their legal services qualifications. At the moment, as explained in paragraph 11 above, the definition of AAR means such

ARs are not subject to the detailed requirements in the Schedule to the IGR.

65. The definition of AAR was developed over the course of our work on the IGR in 2009. The 'primary reason' element in the current definition was introduced with a view to proportionality and flexibility for ARs that are principally supervised by oversight regulators in other professional sectors. This was on the basis that new ARs likely to fall into this category would have responsibility only for a very narrow range of reserved legal activities and very few authorised persons. This meant that the application of the Schedule to the IGR to such ARs would not be automatic, but rather it would be for each affected AR to agree with the LSB what arrangements must be made.[21]

66. We were clear at that time and subsequently[22] that a regulator's circumstances, including its scope of regulation, numbers of authorised persons and the length of time operating as an AR, would be relevant to the appropriateness of its governance arrangements. We have also continued to highlight our intention to keep the definition of AAR under review. ICAEW, which has since 2014 been a regulator for probate services, is presently the only regulator which has both regulatory and representative functions and is not an AAR. There have been changes in its circumstances since the LSB last considered the definition of AAR, for example it is now the second largest regulator of ABS.[23, 24]

67. Alternative (i) in paragraph 64 (i.e. tailored agreements between the LSB and each AAR) might deliver clearer and more effective outcomes in terms of regulatory independence through agreements giving specific consideration to each AAR's circumstances. However, the need for periodic review results in some uncertainty for AARs and might also run the risk of inconsistency of approach between AARs over time. It would also be likely to involve greater resources in putting in place and maintaining agreements, which could be disproportionate relative to the expected benefits.

68. Alternative (ii) in paragraph 64 (reviewing the exclusion of certain ARs from the AAR definition) could provide an opportunity to modify the AAR definition to reflect more closely the original policy rationale for excluding some ARs from the AAR definition i.e. on the grounds of proportionality. This would continue to allow ARs to make the case that they should be excluded from the full scope of the IGR on those grounds. On the other hand, allowing some ARs with both regulatory and representative functions to remain excluded from the full scope of the IGR

[21] See, in particular, paragraphs 4.3 to 4.8: Internal Governance and Practising Free Rules, Response to Consultation, December 2009 - http://www.legalservicesboard.org.uk/what_we_do/consultations/closed/pdf/response_lsb_101209_2.pdf
[22] See paragraph 39: Chairs of Regulatory Boards, Summary of responses and decision document, February 2014 - http://www.legalservicesboard.org.uk/what_we_do/consultations/closed/pdf/20140219_LSB_Lay_Chairs_Summary_Of_Responses_And_Decision.pdf
[23] As at March 2017, ICAEW licensed 185 ABS. By comparison, the SRA was the largest licenser of ABS with 566.
[24] In accordance with our statutory role, the LSB scrutinised ICAEW's recent application to extend the scope of its regulation of legal services against the current IGR (amongst other things) and in accordance with what is laid out in the Act. The Act gives the Lord Chancellor the final decision on designation applications and it is a decision that is his alone to make. The reasons for his decision are set out in his decision letter (and included concerns related to regulatory independence, as discussed at paragraphs 19 and 67).

would not address concerns about the resulting risks to regulatory independence such as those expressed by the Lord Chancellor recently, in his decision not to extend the designation of ICAEW as an AR and a licensing authority (see paragraph 19). In addition, it is resource intensive for the LSB and such ARs to reach individual agreement on appropriate arrangements for independence.

69. Alternative (ii) in paragraph 64 could be taken further and the 'primary reason' carve out could instead be removed from the AAR definition altogether. This could provide greater clarity for, and consistency in the treatment of, ARs with both representative and regulatory functions. While this change could increase the regulatory burden imposed by the LSB on affected ARs, we also note that some stakeholders have told us that the current arrangements result in inconsistent regulatory burdens that may adversely affect competition – see paragraph 33.

The definition of regulatory independence

70. As explored in Annex A, the LSB must make IGR for the purpose of (among other things) ensuring regulatory functions are so far as reasonably practicable independent of, and not prejudiced by, representative functions. As noted at paragraph 8, the IGR currently define regulatory independence in terms that structures or persons with representative functions must not have undue influence or control over the performance of regulatory functions.[25] Undue influence is then defined itself, as '*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'.* This approach could be described as a narrow definition, and it may be that it is too narrow. On the other hand, we have heard that stakeholders find language of this type to be imprecise and difficult to apply in practice. We are, therefore, interested to understand whether these (and other) definitions contribute to current problems with the IGR and would benefit from review.

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

Question 10: What new obligations would you recommend the LSB prioritises, and why?

Question 11: What do you anticipate the impact of those proposed new obligations would be, and why?

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

[25] Part A 1 of the IGR.

Question 13: What do you anticipate the impact of revising the AAR definition would be, and why?

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

Option 2c: a new approach

71. Some ARs and regulatory bodies have told us that they would prefer starting afresh with entirely new IGR, rather than amending the existing IGR. As with options 2a and 2b, option 2c would seek to give greater clarity on the residual role of the AAR[26] once it has delegated its regulatory functions. Option 2c involves exploring how the appropriate level of AAR oversight might be achieved using a greater level of prescription than options 2a and 2b.

72. AARs and regulatory bodies have a legitimate need for information from each other. AARs need information about their regulatory body, for example, in relation to risk management and performance, to satisfy the AARs' obligations under the Act and elsewhere. Option 2c seeks to explore to what extent that need can be satisfied, potentially without the level of detailed interaction between AARs and regulatory bodies that takes place today.

73. As discussed above, we are interested to understand if greater transparency could have a role to play. Could regulators (whether - preferably - through publication or by direct provision to the AAR) be required to provide sufficient information to the AAR for the AAR to identify possible issues before something goes wrong? Building on this idea (and similar to the approach taken in the field of healthcare), would it be possible to introduce a provision in the IGR akin to a duty of candour, i.e. a requirement on the regulatory body to notify its AAR of circumstances that could give rise to issues that the AAR needs to be aware of to satisfy its obligations under the Act and elsewhere?

74. Under option 2c, if the information provided by the regulatory body to its AAR indicates that problems may be developing (possibly by reference to independent standards or benchmarks), the IGR could specify that an AAR is entitled to seek additional assurance from its regulatory body. The regulatory body could then try to allay valid concerns. The AAR's obligation to ensure that regulatory functions are performed on its behalf would need to be taken into account in considering the reasonableness of limiting its ability to seek assurance in this way in the interests of enhancing regulatory independence.

75. One way that option 2c might be implemented is through the design of a series of 'gateways', which would be the only permissible channels for information and assurance to flow between regulatory bodies and their AARs in the normal course of events. These gateways might relate (amongst other things) to finance, governance or regulatory performance information. The idea of these gateways

[26] Or any analogous AR if the definition of AAR is revised.

would be to provide a greater degree of clarity about the nature and scope of the AAR's permitted oversight, whilst acknowledging that the AAR remains legally responsible for regulation (but does not perform that function). The enhanced clarity would therefore flow from a reduction in the AAR's discretion to oversee its regulatory body. What action it would be reasonable for an AAR to take if the flow of information through a gateway indicated that problems were developing would depend on the circumstances. It might range from seeking/being content that it has received a reasonable explanation to - in an extreme case and in discussion with the LSB - replacing the regulatory board.

76. Information gateways are used in a range of sectors to manage the transfer of information. For illustrative purposes only, with the aim of facilitating understanding and gathering feedback for this consultation, rather than being a concrete proposal at this stage, an example of a gateway for financial information could comprise the following:

    a. a description of the minimum level of breakdown and explanation of the budget that it is necessary for a regulatory body to provide to its AAR

    b. minimum requirements for in-year reporting of actual expenditure by the regulatory body against the budget, and the extent to which in-year variations against the budget need to be communicated to the AAR

    c. an explanation of how an appropriate frequency of in-year reporting might be determined.

77. This could reduce the burden of information requests from the AAR to the regulatory body, as it would stipulate the channels through which information can be requested. Regulatory bodies have told us that there are times that they consider they expend management resources in clarifying requests that extend beyond the residual assurance role of the AAR.

78. Option 2c could also improve the ability of the AAR to carry out its representative functions. It could enable AARs to represent the interests of their practitioners more effectively, since policy positions could be vigorously pursued without being compromised by concerns about risks of 'overstepping the mark' in relation to regulatory independence. Clearly, AARs as representative bodies would continue to be valued stakeholders and we would continue to expect regulators to engage with them (and other stakeholders) as we do now.

79. In terms of best regulatory practice, option 2c has the potential to target action at areas of highest risk and increase transparency. It might also allow best practice from other sectors to be used, in terms of identifying possible gateways and independent benchmarks for triggering an AAR's ability to seek additional assurance. Compared to the other options set out in this consultation document, option 2c would require more work in the shorter term to develop the new IGR and then to modify AAR-regulator arrangements, in order to ensure compliance with them. As such, a longer implementation period could be required and the

proportionality of option 2c would need to be carefully considered. On the other hand, fewer regulator and LSB resources might be required to deal with independence disputes and disagreements in the medium and longer term.

Question 15: Do you agree with option 2c: a new 'gateways' approach to the IGR? Why, or why not?

Question 16: What gateways (i.e. permissible channels for information and assurance to flow between regulatory bodies and their AARs in the normal course of events) do you think would be needed, and why?

Question 17: Do you think independent standards or benchmarks could be used to indicate when AARs are able to seek additional assurance? If so, what are these, and why?

Question 18: What action do you think an AAR should be entitled to take when seeking additional assurance in the circumstances described above, and why?

Question 19: What do you anticipate the impact of and risks associated with the 'gateways' approach would be, and why?

Question 20: What, if any, alternative approach to reviewing the IGR do you suggest the LSB should consider, and why? What impact do you think that would have, and why?

Future assurance of compliance with the IGR

80. The IGR currently require each AAR, jointly with its regulatory body, to:[27]

    a) certify compliance in the manner and form prescribed by the LSB from time to time, or

    b) notify the LSB of non-compliance, providing an explanation of the reasons for it and the timescale, plan and expected cost for achieving compliance.

81. As part of this review, and regardless of whether or not changes are made to the IGR, the LSB is considering how it might gain assurance going forward on compliance with the IGR by AARs.[28] This is one way in which LSB and public confidence in the independence of legal services regulation can be increased.

82. If the IGR are amended and a new assurance process is introduced, AARs will be given a reasonable period of time to implement necessary changes to their arrangements to comply with the amended IGR (as happened when the IGR were first introduced at the end of 2009 in relation to DSC requirements).

83. Some options for how assurance on compliance with the IGR might be secured include one or a combination of the following:

    - LSB led – for example, through re-starting DSC in some form, or as an element of the LSB's regulatory performance assessment

    - AAR and/or regulatory body led – for example, through proactive reporting and/or through the use of third party assurance.

LSB led assurance

84. As outlined at paragraph 36, for the years 2010 to 2013 the LSB required AARs and their regulatory bodies to submit a co-signed assessment (i.e. DSC) of compliance with the IGR.

85. Our focus varied over the four years of DSC. At the outset, there was a broad assessment, as extensive changes were made by AARs to bring their arrangements into compliance with the IGR. The LSB reached agreement in a number of cases on AARs securing compliance within a reasonable period in areas of non-compliance. The subsequent focus of the LSB was typically narrower. For example, while we were generally confident that arrangements could provide a workable framework, we wanted to review the effectiveness of arrangements in practice. This recognised that obstacles to regulatory independence might be cultural as much as structural.

86. The LSB ultimately became concerned about its ability to assess behaviours in practice meaningfully. Assurance by means of DSC during 2010-2013 also

[27] Part E (Ensuring ongoing compliance) 9
[28] Or any analogous AR if the definition of AAR is revised.

appeared to have had limited impact on the number of disputes referred to us by AARs and regulatory bodies. Some stakeholders have suggested that DSC still has merit, albeit perhaps in a modified format, in that it requires both parties to assert their views publicly each year.

87. One option might therefore be to reintroduce a form of DSC. For example, this might see AARs and regulatory bodies reporting separately to the LSB on compliance with the IGR. Separate reporting by the AAR and the regulatory body might provide additional detail and insight into the effectiveness of the IGR. On the other hand, separate reporting would mean that there would not necessarily be any agreement as to the existence of any problems and how they might be resolved. Alternatively, compliance with the IGR could become part of the LSB's regulatory performance assessment. This might require further consultation on and modification of our performance standards.

88. There would be resource implications for the LSB, AARs and regulatory bodies, whether DSC were reintroduced or whether compliance with the IGR became part of the LSB's regulatory performance work. We therefore welcome views on both these options and their relative impact on resources.

Question 21: Do you agree with reintroduction of DSC to assure compliance with the IGR? If so, what form should this take and why? What do you anticipate the impact of DSC would be, and why?

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

AAR and regulatory body led assurance

89. As noted in paragraph 80 the current IGR require AARs, jointly with their regulatory bodies, either to certify compliance or notify the LSB of non-compliance. The LSB would like to understand whether stakeholders consider there is merit in retaining the notification obligation in the current IGR. For example, is it likely that this provision will be used, and what might the impact be of the LSB expecting its use for ad-hoc disputes? Recent examples of disputes would appear to suggest that there is limited agreement between AARs and regulatory bodies on possible instances of non-compliance that would fit with reporting in this way.

90. Alternatively, we would be interested to understand views on the merits of third party assurance on compliance with the IGR. This includes the extent to which any value from third party assurance would depend on the participation of both the AAR and regulatory body. Our experience from our regulatory performance work is that the usefulness of this type of assurance can vary. While an independent perspective can be of value, this is likely to be influenced by the terms of reference given to the third party and the budget and timescales allocated by the AAR and/or the regulatory body to the work. As with separate

reporting of compliance (see paragraph 87), third party assurance would not necessarily deliver agreement between the AAR and the regulatory body as to the existence of any problems and how they might be resolved.

Question 23: Do you agree with the existing option for proactive reporting of non-compliance? If so, why? What do you anticipate the impact of this would be, and why?

Question 24: Do you agree with third party assurance? If so, why? What do you anticipate the impact of this would be, and why?

Question 25: What, if any, alternative approaches to assuring compliance with the IGR do you suggest the LSB should consider, and why? What do you anticipate the impact of these would be, and why?

How to respond

91. The questions posed in this consultation are repeated below for reference:

Question 1: We welcome evidence on (i) the general nature, frequency and impact of disagreements on regulatory independence matters, and (ii) how the IGR are used and their effectiveness in moderating such disagreements.

Question 2: What are the benefits and costs to stakeholders of operating under the existing IGR framework?

Question 3: Do you agree with option 1: no change to the IGR? Why or why not?

Question 4: What information do AARs need to receive from their regulatory body, and why? To what extent can these needs be met through transparency (and vice versa), thereby removing the need for further engagement?

Question 5: Do you want more intervention by the LSB in disputes between AARs and regulatory bodies? If so, what form should this intervention take?

Question 6: Do you agree with option 2a: making incremental changes to the IGR? Why or why not?

Question 7: What incremental changes should the LSB prioritise, and why?

Question 8: What do you anticipate the impact of your proposed change(s) would be, and why?

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

Question 10: What new obligations would you recommend the LSB prioritises, and why?

Question 11: What do you anticipate the impact of those proposed new obligations would be, and why?

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

Question 13: What do you anticipate the impact of revising the AAR definition would be, and why?

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

Question 15: Do you agree with option 2c: a new 'gateways' approach to the IGR? Why, or why not?

Question 16: What gateways (i.e. permissible channels for information and assurance to flow between regulatory bodies and their AARs in the normal course of events) do you think would be needed, and why?

Question 17: Do you think independent standards or benchmarks could be used to indicate when AARs are able to seek additional assurance? If so, what are these, and why?

Question 18: What action do you think an AAR should be entitled to take when seeking additional assurance in the circumstances described above, and why?

Question 19: What do you anticipate the impact of the 'gateways' approach would be, and why?

Question 20: What, if any, alternative approach to reviewing the IGR do you suggest the LSB should consider, and why? What impact do you think that would have, and why?

Question 21: Do you agree with reintroduction of DSC to assure compliance with the IGR? If so, what form should this take and why? What do you anticipate the impact of DSC would be, and why?

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

Question 23: Do you agree with the existing option for proactive reporting of non-compliance? If so, why? What do you anticipate the impact of this would be, and why?

Question 24: Do you agree with third party assurance? If so, why? What do you anticipate the impact of this would be, and why?

Question 25: What, if any, alternative approaches to assuring compliance with the IGR do you suggest the LSB should consider, and why? What do you anticipate the impact of these would be, and why?

92. Any representations should be made to the Board by 5pm on 9 February 2018.

93. We would prefer to receive responses electronically (in MS Word format), but hard copy responses by post or fax are also welcome.

94. Responses should be sent to:

- Email: consultations@legalservicesboard.org.uk
- Post: Legal Services Board, One Kemble Street, London, WC2B 4AN
- Fax: 020 7271 0051

95. We intend to publish all responses on our website unless a respondent explicitly requests that a response (or a specific part of it) should be kept confidential. We will record the identity of the respondent and the fact that they have submitted a confidential response in our summary of responses.

96. If you wish to discuss any aspect of this paper, or need advice on how to respond to the consultation, please contact the LSB by telephone (020 7271 0050) or by one of the methods described above.

97. Any complaints or queries about this process should be directed to the Consultation Co-ordinator, Ian Wilson, at the following address:

    Consultation Co-ordinator, Legal Services Board, One Kemble Street, London WC2B 4AN

    Email: consultations@legalservicesboard.org.uk

Glossary of terms

ABS	Alternative business structures. Since October 2011 providers of reserved legal activities that are licensed by a licensing authority have been able to have non-lawyer involvement (managers and/or owners) in their business
ACCA	Association of Chartered Certified Accountants – AR in relation to reserved probate activities
AR or **approved regulator**	A body which is designated as an approved regulator by Parts 1 or 2 of Schedule 4, and whose regulatory arrangements are approved for the purposes of the Act and which may authorise persons to carry on any activity which is a reserved legal activity in respect of which it is a relevant AR
AAR or applicable approved regulator	Defined in the Schedule to the IGR as an AR 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 AR is those person's qualifications to practise a reserved legal activity that is regulated by that AR
Authorised Person	A person authorised to carry out a reserved legal activity
BSB	Bar Standards Board - independent regulatory body of the Bar Council
CMA	Competition and Markets Authority
CILEx	Chartered Institute of Legal Executives – representative body for Legal Executives
CILEx Regulation	Chartered Institute of Legal Executives Regulation - independent regulatory body of CILEx
CLC	Council for Licensed Conveyancers – the regulator of Licensed Conveyancers
Consultation	The process of collecting feedback and opinion on a policy proposal
DSC	Dual-self certification by AARs and their regulatory bodies on compliance with the IGR
ICAEW	Institute of Chartered Accountants of England and Wales – AR in relation to reserved probate activities
ICAS	Institute of Chartered Accountants of Scotland – AR in relation to reserved probate activities
IGR	The internal governance rules
LA or **Licensing Authority**	An AR which is designated as a licensing authority to license firms as ABS
Lay Person	A person that is not an expert in a specified field. In the context of the LSB, the Act specifies that the Chairman and the majority of members of the Board must be lay people
LSB or **the Board**	Legal Services Board - the independent body responsible for overseeing the regulation of lawyers in England and Wales

LSA or **the Act**	Legal Services Act 2007
PCF	Practising fee or practising certificate fee. A fee payable under the AR's regulatory arrangements as a condition of being authorised to carry on reserved legal activities
Principles of Better Regulation	The five principles of better regulation, being proportional, accountable, consistent, transparent and targeted
Regulated persons	Authorised bodies, and the managers and employees of authorised bodies, of an AR
Regulatory arrangements	AR arrangements, rules or regulations for (as applicable) authorising, licensing and regulating authorised persons, licensed bodies and regulated persons
Regulatory Objectives	There are eight regulatory objectives for the LSB that are set out in the Act: • protecting and promoting the public interest • supporting the constitutional principle of the rule of law • improving access to justice • protecting and promoting the interests of consumers promoting competition in the provision of services in the legal sector • encouraging an independent, strong, diverse and effective legal profession • increasing public understanding of citizens legal rights and duties • promoting and maintaining adherence to the professional principles of independence and integrity; proper standards of work; observing the best interests of the client and the duty to the court; and maintaining client confidentiality
Regulatory Rules	Set out the regulatory arrangements that an AR must comply with in order to be designated as approved regulators for specific reserved activity
Reserved Legal Activity	As defined in section 12 of and Schedule 2 to the Act
SRA	Solicitors Regulation Authority - independent regulatory body of the Law Society

Annex A

Legal context

1. The Act names as ARs bodies that have historically both represented and regulated various legal professions. It also recognises the importance of regulation that is independent of undue influence from representative interests.

2. Section 30 of the Act provides that the LSB must make IGR to be met by ARs for the purposes of ensuring (amongst other things):

    a. that the exercise of their regulatory functions[29] is not prejudiced by any representative functions they may also have

    b. that the AR ensures that the regulatory function is provided with the resources reasonably required to exercise regulatory functions

    c. that decisions relating to the exercise of regulatory functions are so far as reasonably practicable taken independently from decisions relating to the exercise of any representative functions.

3. The requirements that the Act expects the LSB to apply to ARs in the IGR vary in their acuteness. Overarching duties that are unqualified in nature are:

    - that the exercise of regulatory functions are not prejudiced by representative functions[30]

    - the ability for persons involved in the exercise of regulatory functions to engage with bodies (e.g. the LSB and other ARs)[31]

    - making such provision as is necessary for persons involved in the exercise of regulatory functions to be able to notify the LSB if they consider their independence or effectiveness is being prejudiced.

    Duties which are subject to the qualification of '*so far as reasonably practicable*' are that:

    - decisions relating to an AR's exercise of regulatory functions are taken independently[32]

    - use of the power to engage with bodies is independent of, and not prejudiced by, representative functions[33]

[29] Defined in section 21 of the Act.
[30] Section 30(1)(a) of the Act.
[31] Section 30(2)(a) of the Act.
[32] Section 30(1(b) of the Act.
[33] Section 30(2)(b) of the Act.

One duty, which is subject to a lower threshold of ARs taking '*reasonably practicable*' steps, is ensuring that resources reasonably required for or in connection with the exercise of regulatory functions are provided.

4. This framework explicitly constrains the AR (and, as a result of the IGR, the AAR in particular) role concerning regulation. However, since any use by the LSB of its enforcement powers,[34] including in relation to the IGR, will be against the AR named in the Act, ARs have a legitimate interest in being assured that regulation is being delivered appropriately.

5. We are clear that in making the IGR, we must work within the settlement described above and cannot introduce requirements that would in effect modify or rescind it, since that is a matter for Parliament. This means, for example, that we cannot compel full independence for legal services regulators, for instance, through the creation of entirely new and separate bodies to carry out regulatory functions without any reference to the AR. Likewise, we are unable to specify legal separation of legal services regulators from the ARs from whom their regulatory functions have been delegated, for example, requiring the AR to set up a subsidiary with a separate legal identity to carry out its regulatory functions. By contrast, ARs may elect to do these things and some have chosen to do so.[35]

6. In setting requirements in the IGR, as with everything we do, we must discharge our duty to promote the regulatory objectives and to have regard to best regulatory practice.[36] Among other things, this means we will continue to see ARs able to select the legal structure most appropriate to their circumstances. For example, this may include limited companies, where ARs have chosen a separate legal structure for their regulator, and different approaches within a single entity.

7. It has been suggested that a power available to the LSB under the existing legal framework, and which we should exercise in relation to regulatory independence, is cancellation of approval or 'de-designation' as an AR. This reflects that the Act provides the LSB with a range of enforcement tools, including de-designation, which it can use in specified circumstances. These include failure to comply with section 30 of the Act.

8. A statement of policy sets out our approach to compliance and enforcement and the way that we will use our enforcement powers.[37, 38] It also explains how we will conduct investigations, including how we will gather evidence and information to

[34] Sections 31 to 45 of the Act.
[35] For example, current structures include regulatory bodies established as separate private limited companies, with the AR as the relevant shareholder, and a regulatory body established as a private company limited by guarantee.
[36] Section 3 of the Act.
[37] In accordance with section 41 of the Act. The LSB is required to make certain rules about aspects of its enforcement functions. Those relating to de-designation are included at Annexe 6 to our statement of policy. A diagram of the de-designation process is at page 38:
http://www.legalservicesboard.org.uk/what_we_do/consultations/closed/pdf/statement_of_policy_compliance_and_enforcement_v2_november10.pdf
[38] A separate statement of policy applies in relation to cancellation of designation as a licensing authority:
http://www.legalservicesboard.org.uk/what_we_do/regulation/pdf/cancellation_of_designation_la_statement_of_policy_3.pdf

inform our decisions, and take account of the desirability of informal resolution and best regulatory practice.

9. Our view is that, short of a systemic failure of an AR, which is not currently the case, de-designation would be disproportionate. It would, for example, see the authorised persons of the former AR need to transfer to another AR. We would use it only in exceptional circumstances when we are satisfied that none of our other enforcement powers would adequately address the issues. However, even if we were to make a recommendation, the Lord Chancellor can decide not to cancel the AR's designation.[39]

[39] If the Lord Chancellor does make the order, any corresponding designation as a licensing authority for the relevant reserved legal activities is also automatically cancelled.

Annex B

LSB regulatory oversight

1. Our oversight of ARs includes regulatory performance evaluation and a number of statutory functions that are specified in the Act. These provide us with insight into, and in certain circumstances some powers in relation to, the application of the ARs' regulatory functions. Among others, our statutory functions include the approval of applications for practising fees (also known as practising certificate fees (PCF))[40] and applications for alterations to regulatory arrangements (rule change applications).[41]

2. As discussed above at paragraph 35 of this consultation, AARs do not always appear to take account of the oversight role of the LSB when framing their own oversight requirements for their regulatory bodies. This includes our work on regulatory performance, assessing practising fees and rule change applications. This may be because AARs established their requirements for their regulatory boards before the LSB had fully developed its oversight activities. Whatever the reason, this has the potential to lead to duplication of effort and excessive burdens on regulatory bodies. This is because, while the AAR may need assurance on some of the same matters as the LSB and may need assurance at a different point in time from the LSB, there should be scope for the AAR to gain this assurance (at least in part) by building on the LSB's work rather than replicating it.

3. Outlined below is a summary of the work that the LSB does in the areas of regulatory performance, PCF and rule change applications.

Regulatory performance

4. The LSB consulted recently on a revised approach to regulatory performance, which proposed that we assess the regulators against five standards. These cover their core regulatory functions and their ability to govern and lead effectively.[42]

5. We proposed undertaking such assessments using a variety of evidence sources such as a performance management dataset, stakeholder feedback and publicly available information from the regulators such as board papers. The proposed framework builds on our previous 'regulatory standards' work and benefits from the learning we have gained from reviewing other processes and speaking with stakeholders and interested parties. It also takes account of the regulatory objectives, the better regulatory principles and best regulatory practice and is in

[40] http://www.legalservicesboard.org.uk/Projects/statutory_decision_making/section_51_practising_fees.htm#feerules
[41] http://www.legalservicesboard.org.uk/Projects/statutory_decision_making/alterations_to_regulatory_arrangements.htm
[42] The LSB's *Consultation on the proposed revised regulatory performance assessment process* and supporting documents can be found through this link.

line with government policy as set out in the Regulators' Code and the Cabinet Office's Regulatory Futures Review.

6. As with our previous regulatory standards work, our assessment of each of the regulators will continue to be published on the LSB website.[43]

PCF applications

7. The LSB is required under the Act to approve the level of PCF annually. For AARs[44] that have delegated their regulatory function to another body, that regulatory body is required to be involved in the setting of the PCF, and therefore has very close engagement in the regulatory budgeting processes. Whether an AR has appropriately consulted on their application is an important element in the LSB's assessment of a PCF application. The LSB expects that the AR will normally consult, particularly where there is a proposal to increase the fee.

8. The LSB evaluates the application against the criteria in the Act and its PCF Rules.[45] Any application that proposes an increase in PCF is scrutinised very closely by the LSB under the PCF Rules, and ARs are required to provide a three year budget forecast (which we publish, as it is part of the AR's application).

Rule change applications

9. When an AR or regulatory body (acting under delegated authority) of an AAR proposes to alter its regulation arrangements it must, under Schedule 4 to the Act, submit an application to the LSB.[46] Applications must demonstrate compliance with the criteria set out in the LSB's Rules for Rule Change Applications in order to be considered for approval. These identify information that must be provided to the LSB.

10. If the proposed changes are significant and alter the regulatory policy or approach, we expect that the regulator would normally consult publicly. If the representative body or any other stakeholder provides a representation to the consultation, we would expect their representation to be noted and we expect the regulatory body to demonstrate that it has properly considered the representations made to it by the regulator in the rule change application.

11. Following consideration and if satisfied that the change can be approved (by reference to the criteria in the Act),[47] the LSB will grant an application (either in whole or in part).

[43] http://www.legalservicesboard.org.uk/projects/developing_regulatory_standards/index.htm
[44] In the case of The Law Society, Bar Council and CILEx, they are responsible in large part for the drafting and submission of their PCF applications.
[45] The LSB's *Guidance to Approved Regulators on Practising Certificate Fee (PCF) applications* can be found here
[46] The LSB's *Rules for Rule Change Applications* can be found here, and our guidance for submitting applications here
[47] Paragraph 25(3) of Schedule 4 to the Act.

Annex C

Background to the IGR

1. This annex and Figure 2 below present a brief overview of the development of the IGR in previous LSB consultations. The documents and the responses to them are available on our website.

March 2009: initial consultation

2. In March 2009, the LSB launched an initial consultation on proposed rules under sections 30 and 51.[48] The LSB had a statutory deadline of 31 December 2009 to make its rules under both these sections of the Act. The consultation focused on setting rules for the future, not passing judgement on how far existing arrangements might meet those rules. The proposals in the consultation aimed to be principles-based and avoid 'one size fits all'. It was acknowledged that what was proportionate might differ depending on the regulator to which the principles were to be applied.

3. Some of the key proposals were:

    - Each AR that has representative functions (an AAR – the definition did not include 'primary reason' element at this stage) was to establish a separate regulatory body, with the power to control its own structure, processes and procedures and to determine its strategic direction. It was noted that this went wider than just the power to make decisions in specific cases.

    - All appointments to regulatory bodies were to be through open advertisement and competition made on merit. The board of the regulatory body was to have a lay majority. Appointment panels (and arrangements for appraisal and dismissal) were to be independent of representative control.

    - The legitimate exercise of an AR's supervisory functions in respect of its regulatory body was itself to be conducted in a way that was clearly independent of representative control.

    - Each AR was to certify its compliance at regular intervals, each regulatory body was to certify separately its agreement with that self-certification.

4. Paragraphs 3.25 to 3.30 of the March 2009 consultation discussed the AR's residual oversight function. It was noted that the AR was responsible in law for the discharge of its regulatory functions under the Act and the IGR. In particular:

    - LSB action under sections 31-48 of the Act has to be directed at the AR – this covers setting/directing performance targets, giving directions, issuing

[48] http://www.legalservicesboard.org.uk/what_we_do/consultations/2009/pdf/regulatory_independence.pdf

censures, imposing financial penalties, intervening in the discharge of functions and cancelling designation as an AR.

- What remains for the AR after it has delegated its regulatory functions to a separate body is limited, and the exercise of its supervisory role should not compromise the independence or effectiveness of the regulatory body.

- The LSB at that time saw two possible residual supervisory roles for the AR:

    - commissioning occasional independent strategic reviews of its structural framework. The LSB considered that the AR *in extremis* should have the power to dismiss one or more regulatory board members, but only then with LSB agreement (even if regulatory body agreed)

    - monitoring the work of the regulatory body, to assure itself that the responsibilities imposed on it by statute are being discharged. Monitoring must be proportionate, not require burdensome compliance, and stop short of allowing the AR to require any action or omission from the regulatory body. The regulatory body should cooperate with AR monitoring. Supervisory functions may in practice sit best with a body that is independent of representative control, e.g. the body established to oversee provision of (and resolve disputes about) shared services.

5. Paragraph 19 of Annex B of the March 2009 consultation noted that "*When considering the degree of 'separation' envisaged between regulation and representation, our view is that Parliament did not intend to mandate institutional separation. However, there was an expectation that clear and robust separation of function could and should be achieved, both in terms of appearance and reality, where any approved regulator also had representative responsibilities*".

September 2009: supplementary consultation

6. The LSB issued a supplementary consultation in September 2009[49] in which the proposed IGR were significantly revised and developed following the LSB's consideration of the responses to the March 2009 consultation. By this time, the LSB had also settled on a 'house style' for statutory rules, built around the concept of principles, rules and guidance and so the proposed IGR were put into this format.

7. Some key developments were:

    - appointments to regulatory boards – **"***LSB now considers that it is not essential for regulatory arms to have full control of all aspects of the appointments process, but, where they do not have control, there must be*

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

compelling evidence that they have a strong voice in the process and that the appointment arrangements put in place satisfy the wider scheme of rules." (paragraph 3.17)

- approach to implementation and compliance – the LSB proposed a risk-based approach, through DSC.

December 2009: decision

8. The LSB published its initial IGR in December 2009.[50] Key final developments following the previous consultations were:

    - The definition of AAR was varied to exclude regulators principally supervised by oversight regulators in other professional sectors. The main reason given for this change was proportionality. It was noted that the IGR could conflict with a new AR's adherence to other oversight regulations. It was also noted that the proportionality argument also depended on the size of the regulator, the number of authorised persons it regulates, the number of reserved activities it regulates and the time it has been operating as an AR.

    - The requirement for lay majorities for regulatory boards was maintained. It was considered that the public needed assurance that regulation was not driven by interests of profession.

    - It was noted that various issues regarding the residual role of an AAR once it has delegated its regulatory functions remained contentious. At paragraph 4.38 the decision document stated that "*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*." Amongst the contentious issues was an AAR's residual powers to hold its ring-fenced regulatory body to account. Paragraph 4.71 of the decision stated that "*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. … All sides – LSB, AARs and regulatory bodies – must recognise the need for appropriate balance and strive reasonably to achieve that balance*."

October 2013: consultation on amendment to IGR to require lay chairs of AAR regulatory boards

9. The LSB launched this consultation[51] because (as noted in paragraph 2 of the 2013 consultation) it considered that after four years' experience of the IGR, AARs were still tied too closely to the profession. It considered that overly strong

[50] http://www.legalservicesboard.org.uk/what_we_do/consultations/closed/pdf/response_lsb_101209_2.pdf
[51] http://www.legalservicesboard.org.uk/what_we_do/consultations/pdf/lsb_consultation_on_lay_chairs_08_10_13.pdf

ties to the history, culture and rules of the professional self-regulators were having a negative impact on better regulation principles and putting the regulatory objectives at risk.

10. As explained in paragraph 16 in the 2013 consultation, the LSB believed there was a case for change based on:

    - the LSB's day-to-day interaction with approved regulators
    - the LSB's almost four years of experience of carrying out the dual self-certification process and dealing with rule change applications
    - knowledge gained from the LSB's regulatory standards work
    - learning from the (at that stage ongoing) Bar Council investigation.

11. The LSB noted at paragraph 3 of the 2013 consultation that it considered that lay chairs for AARs were likely to improve outcomes and deliver greater independence from representative bodies and profession. Although rejected in 2009, the LSB considered that there was now more evidence that a more onerous measure was justified.

February 2014: decision on lay chairs and further consultation

12. In February 2014, the LSB published its decision to amend the IGR to require lay chairs of AAR regulatory boards.[52]

13. The LSB also launched a new consultation on further changes to the IGR to require that regulatory bodies rather than professional bodies are responsible for certain aspects of the appointments and reappointments process for board members and their chairs. As noted at paragraph 22 of the 2013 consultation, the LSB proposed that existing position be reversed so that regulatory bodies would have responsibility for appointments and reappointments but would be expected to strongly involve the parent AAR at all stages, consulting them on the key aspects of the process.

April 2014: decision on appointments and reappointments process

14. In April 2014, the LSB published its decision to amend the IGR[53] to require that, in the case of AARs:

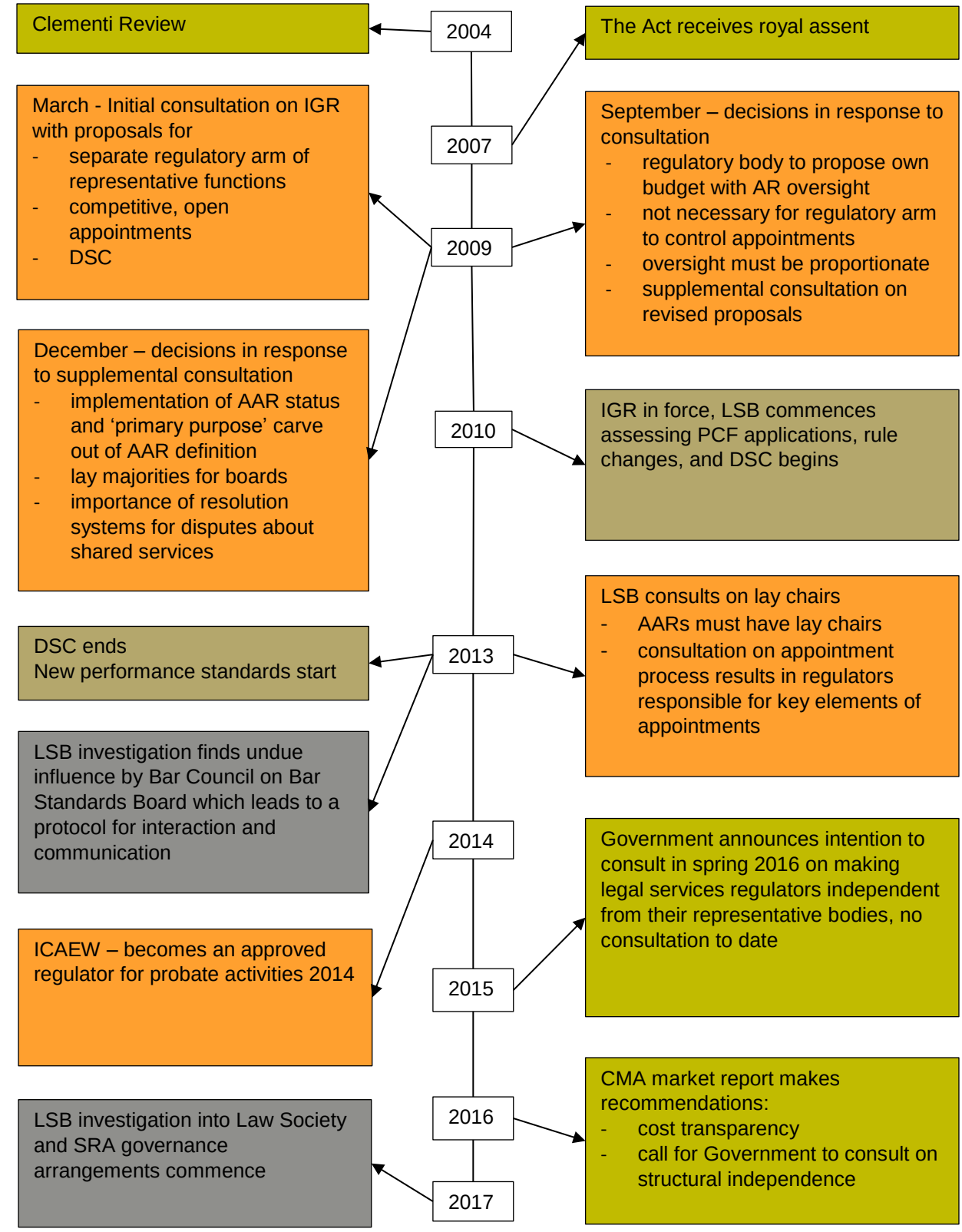
    - regulatory bodies are responsible for designing the competency requirements for their chair and board members

[52] http://www.legalservicesboard.org.uk/what_we_do/consultations/closed/pdf/20140219_LSB_Lay_Chairs_Summary_Of_Responses_And_Decision.pdf
[53] http://www.legalservicesboard.org.uk/what_we_do/consultations/closed/pdf/20140430_LSB_%20appointments_reappointments_%20summary_and_decision_document.pdf

- regulatory bodies are responsible for designing and managing the appointments and reappointments process for their chair and board members

- the process and decisions on appointments and reappointments of regulatory chairs are delegated to an appointment panel independently constituted in line with best practice.

Figure 2


Clementi Review
2004
The Act receives royal assent
March - Initial consultation on IGR with proposals for
- separate regulatory arm of representative functions
- competitive, open appointments
- DSC
2007
September – decisions in response to consultation
- regulatory body to propose own budget with AR oversight
- not necessary for regulatory arm to control appointments
- oversight must be proportionate
- supplemental consultation on revised proposals
2009
December – decisions in response to supplemental consultation
- implementation of AAR status and 'primary purpose' carve out of AAR definition
- lay majorities for boards
- importance of resolution systems for disputes about shared services
2010
IGR in force, LSB commences assessing PCF applications, rule changes, and DSC begins
DSC ends
New performance standards start
2013
LSB consults on lay chairs
- AARs must have lay chairs
- consultation on appointment process results in regulators responsible for key elements of appointments
LSB investigation finds undue influence by Bar Council on Bar Standards Board which leads to a protocol for interaction and communication
2014
Government announces intention to consult in spring 2016 on making legal services regulators independent from their representative bodies, no consultation to date
ICAEW – becomes an approved regulator for probate activities 2014
2015
CMA market report makes recommendations:
- cost transparency
- call for Government to consult on structural independence
LSB investigation into Law Society and SRA governance arrangements commence
2016
2017
External reports/events
LSB policy development
LSB assurance developments
LSB investigations

Annex D

The current IGR

Version 3: 30 April 2014

The Legal Services Board has, on 9 December 2009, made the following rules under Legal Services Act 2007 (c.29), section 30(1) – (as amended 20 February and 30 April 2014):

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
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
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 COMPLIANCE

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 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: • ensure that it does not contradict or add material new requirements to any rules or guidance made by the regulatory body/bodies; and • consult with the regulatory body/bodies when developing that guidance.
	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: • a majority of members of the regulatory board are lay persons; and • the chair of the regulatory board is a lay person	
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.	**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.	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. This includes publishing clear criteria for available roles and publishing details of the selection process[54].
		The appointments panel should be – and should be seen to be – capable of producing a qualified and independent regulatory board. This is likely to mean having: • having at least one lay representative on the appointments panel or equivalent • having at least one representative external to the AAR and regulatory board on the appointments panel or equivalent
	B: The regulatory body must be responsible for: • designing competency requirements • designing and managing the appointments and reappointments process	The regulatory board should strongly involve the AAR at all stages - fully consulting it on the key aspects of the *appointments and reappointments process.* *A proper audit trail of the discussions, the points considered and final decisions made should be maintained.*

[54] This should apply to roles on the appointment panel as well as roles on the regulatory board

(2) All persons appointed to regulatory boards must respect the duty to comply with the requirements of the Legal Services Act 2007.	**C.** 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.	
		A representative of the AAR should always form part of the appointment panel or equivalent
		The process and decisions on appointments and reappointments of regulatory chairs should be delegated to an independent appointment panel or equivalent
		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.
	D. 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; • 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; • Reappointments – decisions should be guided by objective appraisals and the desirability of ensuring a balance between regular turnover and continuity.

	E. 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.	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.
		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 choose to make.
	F. 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. 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. 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 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.	**A.** Defining and implementing a strategy should include: • access to the financial and other resources reasonably required to meet the strategy it has adopted; • effective control over the management of those resources; and • the freedom to govern all internal processes and procedures.	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.
		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. 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. 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.
	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 being met.
		When considering whether arrangements meet the required standards, the Board will consider factors such as: • 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; • provision being made for service level agreements agreed between respective parties; and • transparent, fair and effective dispute resolution mechanisms being in place.

Part 4: Oversight etc 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.	**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 intervention, or the making of directions, in respect of the management or performance of regulatory functions unless with the concurrence of the Board.	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.