

Regulatory Independence

Response to Consultation

September 2009

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1. Introduction

- 1.1. This document is the response to the consultation paper, *Regulatory Independence*. All submissions received by the Legal Services Board have been published online¹. A list of respondents is included at **Annex A** to this report.
- 1.2. This report includes:
 - the background to the consultation paper;
 - a high-level summary of responses overall;
 - a more detailed summary of responses to each of the questions posed by the consultation paper; and
 - an outline of the general conclusions and next steps following this consultation.
- 1.3. Published alongside this response document is a second consultation document, *Internal Governance and Practising Fee Rules*, which proposes a set of statutory rules developed and informed by the submissions summarised in the following chapters.
- 1.4. This response document, the earlier consultation paper and the new consultation paper are all available on the Legal Services Board's website.
- 1.5. If you are unable to access electronic copies of the documents, it may be possible to send you a hard copy. Please contact:

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¹See:

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

2. Background

- 2.1. The Legal Services Board (LSB) published its consultation paper, *Regulatory Independence*, on 25 March 2009. The paper sought views on a set of draft rules to be made under sections 30 and 51 of the Legal Services Act 2007 ('the Act'). The deadline for submissions was 26 June 2009.
- 2.2. The consultation was the first phase of an engagement strategy designed to culminate in the LSB making rules before the end of 2009. The launch of the next formal phase of that engagement strategy coincides with the publication of this document.

The proposals

- 2.3. The consultation paper, *Regulatory Independence*, explained the context in which its proposals had been framed. That context was shaped by the 2004 report² by Sir David Clementi and the Government proposals that flowed from it³. The general principle that regulatory functions should be (and should be seen to be) discharged separately from any representative functions was a central tenet of that early work.
- 2.4. That context also shaped the legislation which now governs the regulatory framework across the legal services sector in England and Wales. It is that legislation, the Legal Services Act, which defined the task of the LSB. In particular, two provisions were relevant to the *Regulatory Independence* consultation: sections 30 and 51.

Section 30: Internal Governance Rules

- 2.5. Section 30 of the Act deals with the exercise of regulatory functions by approved regulators. It provides that the LSB must make Internal Governance Rules (IGRs). Those rules must require approved regulators to ensure that the exercise of their regulatory functions is not prejudiced by any representative functions they may also have; and that they must, so far as reasonably practicable, ensure that decisions relating to the exercise of their regulatory functions are taken independently from decisions relating to the exercise of any representative functions.
- 2.6. The consultation paper proposed rules which would oblige each of the approved regulators with dual regulation/representation responsibilities to separate their

² *Review of the Regulatory Framework for Legal Services in England and Wales – Final Report* (December 2004), Sir David Clementi: <http://www.legal-services-review.org.uk/content/report/report-chap.pdf>.

³ For example, the White Paper, *The Future of Legal Services: Putting the Consumer First*: <http://www.dca.gov.uk/legalsys/folwp.pdf>.

regulatory and representative functions. We suggested that the necessary separation should be achieved by ring-fencing the discharge, management and control of the regulatory functions. The consultation paper highlighted that such rules would probably not impact significantly on the Council for Licensed Conveyancers or the Master of the Faculties because of their lack of any representative role⁴.

- 2.7. The consultation paper was clear that approved regulators must remain ultimately responsible for the overall discharge of regulatory functions: they are designated by statute as the bodies vested with the power to regulate. Insofar as ring-fencing was concerned, the consultation paper suggested that, while constitutionally the regulatory arm of an approved regulator might be a subsidiary company, board or committee of the overarching approved regulator, in all practical respects that regulatory arm should control and manage the discharge of the approved regulator's regulatory functions. The regulatory arm should also be insulated under the terms of the constitutional arrangements from the risk or reality of prejudice or other undue interference from those in post for representative purposes.
- 2.8. Proposals were then set out as to specific areas where delegation or ring-fencing of responsibility would be important. The consultation paper covered:
- the appointment, reappointment, appraisal and discipline of regulatory board/equivalent members;
 - the control and management of resources, including any corporate shared services; and
 - the way in which approved regulators should supervise and monitor the discharge of the ring-fenced regulatory functions, whilst respecting the fundamental tenets of regulatory independence.
- 2.9. The consultation paper then proposed a mechanism through which the LSB could assure itself that the rules it makes are complied with. The model outlined was based on the concept of "dual self-certification".

Section 51: Practising Fee Rules

- 2.10. Section 51 provides for the control of practising fees charged by approved regulators. Under the provision, the LSB must make rules that specify for what "permitted purposes" approved regulators may apply amounts raised by practising fees paid by their practitioner members. Because the LSB has a responsibility to approve the level of any practising fees charged by approved regulators, it must also make rules about how applications for approval are to be made, considered and decided upon.

⁴ Legislation explicitly requires the Internal Governance Rules to apply to "each" approved regulator. Paragraph 4.14 and footnote 15 explain the position in more detail.

2.11. In outline, the proposals here included:

- a small extension of the permitted purposes, i.e. the purposes for which monies raised through practising fee levies can be applied, to ensure that approved regulators can fund any work under or in connection with the regulatory objectives established in the Act;
- a flexible process to require each approved regulator to agree arrangements with the Board to ensure that applications for the approval of practising fee levels are made in good time for the relevant budget cycle; and
- a requirement to observe the regulatory objectives and the principles of better regulation entrenched in the Act (in particular the principle of transparency) when seeking to agree the level of practising fees for the relevant time period.

The process

2.12. The consultation paper posed 19 questions on the various proposals. Sixteen of those questions focused on aspects of policy articulated in the main body of the consultation paper. The final three questions focused on, respectively, the proposed draft rules, the annexed draft impact assessment, and the entire package of proposals (as opposed to specific aspects of it), giving the opportunity to raise any issues not covered in other parts of the consultation paper.

2.13. After the consultation paper was published in March, the LSB engaged on a one-to-one basis with a range of stakeholders. A list of the organisations with which the LSB had meetings is included at **Annex B**. These meetings tended to focus on the issues which were highlighted in the consultation paper as requiring more attention, namely:

- the timeframe for full implementation of the LSB's settled rules;
- the practical mechanics of 'dual self-certification';
- the criteria against which the LSB should consider applications under section 51 for practice fee approval; and
- the position of smaller regulators and how the LSB could ensure proposals respected the principle of proportionality.

2.14. While forming an important part of the consultation process, these meetings afforded stakeholders with the opportunity to feed back emerging responses. Views expressed, therefore, were largely provisional and subject to the views settled in formal responses submitted later in the consultation process. With two

exceptions⁵, all organisations which met with the LSB submitted formal responses to the consultation.

⁵ The Ministry of Justice and Monitor met with the LSB but did not submit a formal response.

3. General summary of responses

- 3.1. Forty respondents submitted responses to the *Regulatory Independence* consultation paper. In addition, the LSB gathered evidence by meeting stakeholders during the consultation period and by hosting a workshop event after the consultation period.
- 3.2. This chapter summarises:
 - the range of organisations and individuals that submitted responses;
 - the level of support that the consultation paper's proposals received; and
 - common themes that arose throughout the consultation process.

Analysis of respondents

- 3.3. The 40 respondents, listed in alphabetical order in **Annex A**, included a range of individuals (nine) and organisations (31). The LSB is extremely grateful to all those who submitted responses. In particular, the LSB would like to thank respondents for the quality of responses and for the time that evidently went into their preparation.
- 3.4. Of the nine **individuals**, five were qualified solicitors with current practising certificates, whilst the remainder were qualified solicitors and/or associated to the Law Society. Among the nine, four respondents were members of the Law Society Council, but explicitly responded in their respective personal capacities rather than on behalf of the Society or its Council. Another of the individual respondents was President of a local Law Society. No non-legally qualified individual responded, whether as a consumer of legal services or otherwise.
- 3.5. Of the 31 **organisations** to respond, there were:
 - seven of the eight statutorily designated approved regulators (including both of the approved regulators without any 'representative' functions);
 - three "regulatory arms", forming part of respective approved regulators (with a further regulatory arm submitting a joint response with its overarching approved regulator);
 - seven sectoral or geographical representative societies or associations for lawyers (including five local Law Societies);
 - five bodies involved in administering or overseeing different parts of the legal services sector;
 - three law firms of varying sizes;

- three consumer organisations (including a consumer panel of one of the approved regulator’s regulatory arms); and
 - three regulatory authorities from outside the legal services sector.
- 3.6. The majority of responses therefore came from individuals or organisations within the legal services sector and/or from a legally qualified perspective. However, the respondents representing the interests of consumers came to the debate with significant experience of the legal services sector. And two of the organisations involved in the administration/oversight of the sector are bulk purchasers of legal services. One is in fact the single largest purchaser of legal services in England and Wales⁶.
- 3.7. The range of responses, therefore, has proved a solid and reliable base on which to assess the proposals put out for consultation.

Level of support for proposals

- 3.8. The consultation paper focused on a number of issues. The vast majority of questions were posed in respect of specific issues of detail, rather than broader issues of principle. Attempting to pigeonhole submissions into particular categories is therefore difficult, especially because of the complexity of the arguments underlying many responses.
- 3.9. Whilst difficult, it is perhaps useful to summarise broad sentiment expressed across the board. Of course, such summary must carry appropriate health warnings: the detailed analysis in the following chapter must be considered in order to appreciate the full range of opinions expressed on each area of detail covered.

Indicative levels of support

- 3.10. In broad terms, consultation submissions can be marshalled into three groupings, namely those which appeared to the LSB as:
- generally **supportive** of the package of proposals consulted upon and, where taking issue with any particular point of detail, tended to urge the LSB to go further in ‘cementing’ the reality and perception of ‘independence’ (almost half of respondents);
 - generally **concerned** about the proposed package, with issues as to detail tending to suggest that the LSB was overstepping the ambit of its discretion (just over a quarter of respondents); and

⁶ The Legal Services Commission spends £2bn a year on purchasing legal services. The Crown Prosecution Service is also a significant bulk purchaser.

- generally **neutral**, or difficult to fit in either of the other two categories (just over a quarter of respondents).

Common themes

Effective separation and ring-fencing of the regulatory functions of approved regulators which also have representative functions is central to the operation of the two-tier structure of regulation envisaged by the Legal Services Act.

Legal Services Policy Institute, College of Law

- 3.11. Since Sir David Clementi's report⁷, there has been broad consensus as to the shape of the regulatory framework required in the legal services sector. Similarly, responses to the consultation showed a broad consensus over the high-level principles set out by the LSB. Happily, very few if any submissions actively sought to reopen debates long since settled by the Legal Services Act's Royal Assent.
- 3.12. In terms of that consensus, submissions showed broad support for:
- the concept of ring-fenced regulatory functions (although interpretation of what the term "ring-fencing" should mean in practice was less clear cut);
 - the suggested self-certification mechanism designed to ensure compliance with the rules; and
 - the proposals for a practise fee approval mechanism based on memoranda of understanding with respective approved regulators.
- 3.13. Underneath that consensus, a variety of opinions were expressed as to how proposed mechanisms should work in practice. The following paragraphs highlight some of the recurring themes found amongst the forty submissions received.
- 3.14. **To prescribe or not to prescribe?** Many submissions observed that a beauty of the Legal Services Act framework was that it allowed approved regulators to apply principles in the manner most appropriate to the individual circumstances in their respective parts of the profession. The LSB was urged, where possible, to avoid prescribing how principles should be met. Instead, it should explain what ends it seeks to achieve, or what risks it wants to mitigate, then leave approved regulators to demonstrate compliance.

There are no doubt many different ways in which real and effective regulatory independence can be achieved and it is the duty of each AR to choose the most appropriate means of implementation. There is no "one cap fits all".

The Bar Council

⁷ See footnote 2, above.

- 3.15. Some respondents went so far as to say that the LSB should stick to the precise wording of the Legal Services Act when framing rules and go little or no further. That, it was suggested, was the intention and the will of Parliament. Other respondents disagreed. The Bar Standards Board said that “[i]f Parliament had intended that there should merely be the very high-level requirements set out in s.30 itself, then s.30 would not have required the making by the LSB of the [rules]. Making such rules would be otiose if they were merely going to replicate what is already in the Act.”
- 3.16. Clearly, there is a balance to be struck. The proposal developed by the LSB to introduce principles, rules and illustrative guidance, set out later in this response, is designed to achieve this balance. The LSB will not limit itself to reproducing statutory provisions. But it will seek to provide approved regulators with flexibility so that the principles (and, where set out, rules and guidance) can be met in the manner they consider most appropriate.
- 3.17. **Winning the confidence of lawyers and consumers.** The vast majority of respondents accepted the consultation paper’s premise in respect of striving to ensure public confidence in the regulatory framework. Indeed, the focus won praise in many quarters. However, some respondents suggested that the consultation paper had failed to achieve an appropriate balance. One respondent interpreted the proposals as “trying too hard to exclude lawyers from the process... [which] is likely to lead to conflict”.
- 3.18. At least 13 respondents raised this issue and the majority of them urged the LSB to recognise the importance of holding the confidence of the regulated community, as well as consumers and others. One solicitor respondent went so far as to interpret the consultation paper’s proposals as defaming the legal profession. Another said that “[t]o suggest in some way that a Lawyer will be partisan and not understand the importance of clear and robust regulation is an insult to our profession”.

[I]n order for the Legal Services Board to be successful in its aims it needs to embrace the interests of the profession as well as other stake holders. There is a fear that this would be lost in the desire to focus on the interests of the public.

Lincolnshire Law Society

- 3.19. The general point here is well understood. Indeed, the LSB was disappointed that its consultation paper was capable of being understood as a slur on members of the profession. In clear terms: that was not intended. The LSB is under a statutory duty to encourage a strong and effective profession. Furthermore, the public interest and the constitutional principle of the rule of law depend, among other things, on a profession that is (and is seen to be) independent of Government or any other inappropriate external influence. In any event, it has been the stated aim of the LSB to engage constructively with the widest possible range of stakeholders

in building a framework that meets the interests of consumers, lawyers and the general public. That remains a central aim.

3.20. The LSB will not, however, dilute its focus on the interests of consumers. Nor will it ignore the issue of public perception. Evidence⁸ suggests that self regulation, without robust oversight, is no longer trusted. It is not in the interests of an independent, strong, diverse and effective profession to have confidence in it eroded.

3.21. **Value for money.** Proportionality featured as a key issue throughout the consultation exercise. Indeed, it has been a key issue since publication of the Clementi report. Many of the submissions from the legal services sector were foremost in reiterating the importance of the principle. Some cross-referred to the draft regulatory impact assessment⁹, published as an annex to the consultation paper, which highlighted a particular risk that:

“costs passed on by smaller approved regulators (as a direct result of our statutory rules) [may] seem to the respective regulated communities to be disproportionate, [and] many of their members may leave and practice outside the regulatory net. That means the approved regulators will lose membership fee/practising certificate income. It also means that consumers may ultimately find themselves without recourse to regulatory remedies in certain cases.”

3.22. The overarching principle, of course, applies to the larger approved regulators as well as to the smaller ones. Particularly in the context of the current economic climate, a focus from respondents on the costs of reform was unsurprising. Although there was no majority view that LSB proposals were inherently disproportionate, a clear thread running through submissions was that proportionality must not be overlooked.

3.23. A significant number of submissions also expressed a concern that any requirement for institutional separation between approved regulators and regulatory arms would by definition entail additional costs. In particular, approved regulators and those regulated by them argued strongly that corporate services (for example providing finance, IT, HR and accommodation functions) should be shared between approved regulators and their regulatory arms so as to minimise costs.

⁸ In addition to the consumer and purchaser submissions made in respect of this consultation, the thrust of the reforms leading to the Legal Services Act was such that consumer confidence was declining and that self-regulation was not trusted. The 2004 Clementi report concluded that the system at the time had “insufficient regard to the interests of consumers” (page 2 of Sir David’s foreword). While we are no longer in 2004, rules to be made by the LSB must cement robust and effective mechanisms in place.

⁹ Draft Impact Assessment (Annex C of consultation paper), paragraph 25:
[http://www.legalservicesboard.org.uk/what_we_do/consultations/2009/pdf/regulatory_independence.p
df](http://www.legalservicesboard.org.uk/what_we_do/consultations/2009/pdf/regulatory_independence.pdf)

It is universally accepted that the whole economy is moving into an era of severe financial restraint. It is wholly wrong that regulatory arms should be able to fly in the face of this and take actions which will increase costs; they should be looking at ways to reduce them.

John Penley

- 3.24. It is important to clarify that consultation proposals were not designed to prohibit the provision of shared services. Indeed, the consultation paper cited¹⁰ specific benefits made possible by a shared services model, in respect for example of economies of scale. However, proposals were designed to ensure that regulatory functions are discharged with appropriate effectiveness and independence. That remains – and must remain – the focus.
- 3.25. Despite an explicit request in the draft impact assessment, few respondents offered evidence of indicative actual costs of compliance¹¹ – although admittedly it would have been hard to model on the basis of draft rules. The broad conclusion drawn by the LSB is that the proposals as stated so long as sufficient flexibility is afforded, would not entail any significant cost increases for any approved regulator. The LSB is, however, alive to the concerns across the sector.

¹⁰ LSB Consultation Paper, Regulatory Independence, paragraph 3.20.

¹¹ One of the few exceptions was the Law Society's submission (see para 37 of its main paper), which estimated the cost of complying with any enforced prohibition on shared service provision. The estimate made was circa £10m set-up costs followed by circa £5m additional spending per year. As already said, the LSB proposals were not designed to prohibit shared services, nor was an end to the shared services model envisaged as an incidental by-product of the rules proposed, so long as independence and effectiveness can be safeguarded.

4. Summary of responses to specific questions

- 4.1. Nineteen questions were posed throughout the consultation paper. Those questions were set out in a list at the end of the consultation paper's Executive Summary.
- 4.2. Following the structure of the consultation paper, the questions focused, in turn, on the concept of ring-fencing; the appointments etc of regulatory board members; the control and management of resources; the scrutiny and monitoring role for approved regulators over their regulatory arms; the concept of dual self-certification; and the practise fee approval mechanism. The final three questions focused on the proposed set of draft rules, the draft impact assessment annexed to the paper, and on any other issues which respondents felt were not covered in sufficient depth elsewhere.
- 4.3. This chapter summarises responses to each of the questions posed.

Question 1 – Ring-fencing

- 4.4. The consultation paper suggested that, where an approved regulator discharged both regulatory and representative functions, the regulatory functions should be “ring-fenced” so as to secure appropriate independence. Paragraphs 3.4 to 3.13 outlined what, in general terms, the LSB meant by ring-fencing. Question 1 asked how an independent regulatory arm might best be ring-fenced from an approved regulator in such circumstances.

It is of critical importance that the LSB designs and implements a regime that will cast aside any doubts that lawyers continue to make the decisions.

Consumer Focus

The exercise of the regulatory arm's functions should be “ring-fenced”, but the ring should be a fence and not a barricade.

John Adams

- 4.5. The concept of ring-fencing was – at least at a broad level – accepted by the vast majority of respondents. No submission argued that regulatory functions should remain (i.e. without some element of delegation or separation) under the sole control of approved regulators which also exercise representative functions. There were, however, different opinions expressed as to matters of detail.
- 4.6. Approximately half of all respondents either urged adoption of a model akin to institutional separation, or argued in favour of the proposals set out in the consultation paper. Approximately a quarter of all respondents pressed the case for retaining strong involvement of professional bodies and/or the profession itself

in order to achieve effective and robust regulation. Many also considered that there might not be a single “best” model and that each approved regulator should have the flexibility to adopt what works best for it. While each strand of argument is not necessarily mutually exclusive, summarising each in turn is helpful.

- 4.7. **Maximising separation.** A cross section of respondents argued that responsibility for discharging regulatory functions (as defined in the Act) should be delegated “entirely” or “absolutely”. Which? and Consumer Focus have long argued for such separation and their submissions continued to press the case forcefully. Bulk purchasers of legal services like the Legal Services Commission (LSC) and Crown Prosecution Service (CPS) agreed. Some individual members of the profession and representative solicitor and barrister associations advanced similar arguments¹². So too did certain public bodies from inside and outside the sector. For example, the OFT suggested that if approved regulators could not demonstrate an appropriate absence of conflict, the LSB might need to consider complete institutional separation. Sir David Clementi said much the same in his Report¹³.

[T]he independent regulatory arm must be ring-fenced from a representative-controlled AR by a process of complete delegation of regulatory powers. Once delegated, the exercise of regulatory powers must be free from representative interference, undue influence, control or veto. Subject only to (a) residual oversight; and (b) the unavoidable duality of some functions within the B+ model, the ring-fencing of the regulatory arm must be complete.

Bar Standards Board

- 4.8. Insofar as approved regulators and regulatory arms were concerned, most were in broad agreement as to the principles. The Bar Council suggested that a regulatory arm should have delegated to it “all” regulatory responsibilities on behalf of the approved regulator. The Solicitors Regulation Authority (SRA) highlighted the danger inherent in not securing such a broad delegation. Power to affect a regulatory strategy, irrespective of how it is used in reality, could act as a subtle restraining influence on a regulatory board.
- 4.9. **Ensuring professional involvement.** A narrower section of respondents argued cogently and forcefully that the LSB’s job was to ensure adequate separation of functions, not to divorce the profession from its regulation. Whilst in the main agreeing with the LSB’s ring-fencing proposals, the Law Society highlighted the clear distinction between the legal sector and, for example, the medical sector. In the latter, the General Medical Council and the British Medical Association are institutionally separate. In the former, there is no institutional separation and so

¹² See for example the submissions from Mark Frost, the Devon & Somerset Law Society and the Bar Association for Commerce, Finance and Industry.

¹³ See above, footnote 2. In particular, see Chapter B, (page 39) paragraph 39.

the existing approved regulators remain ultimately responsible for effectiveness and propriety.

The question pre-supposes agreement with the manner in which proposals have been made by the LSB. It is our view that the regulation of any professional body should be conducted principally by the members of that professional body.

Tunbridge Wells, Tonbridge and District Law Society

- 4.10. Other submissions were more critical of LSB proposals, at least insofar as they were understood as being focused on addressing alleged consumer perception issues to the exclusion of all else. The Berks, Bucks and Oxfordshire Law Society “venture[d] to suggest that the public have little interest in these proposals and with respect have little chance of understanding [them]”. The Society warned the LSB not to ignore the need to maintain professional confidence. Of course, one of the reasons why statutory¹⁴ regulation is necessary is that the market alone will not operate effectively or fairly enough. This is particularly true where consumers find it difficult to understand the complexities involved, as in this sector.
- 4.11. One solicitor respondent, with whom two other respondents agreed, suggested that rules to be made by the LSB should not allow a regulatory arm to act unreasonably, for example by demanding unreasonable resources. The terms of delegation should therefore include appropriate checks and balances – which should form part of any robust management structure. So while regulatory arms should have functions delegated to them, “challenge mechanisms” should be in place to ensure “well thought out and tightly managed business processes”.
- 4.12. **The need for flexibility.** Flexibility was a key theme running through submissions – in particular those lodged by approved regulators and their regulatory arms.

There may not be a “best way” to ring fence the regulatory arm from the representational functions, given the distinct nature of the various Approved Regulators. We agree that the rules should require this separation, but it must be for each Approved Regulator to determine how it will be done in order to satisfy the LSB.

Institute of Trade Mark Attorneys

- 4.13. A clear message from the consultation responses was that rules made by the LSB must afford approved regulators flexibility to deal with the different circumstances in each branch of the profession. The Institute of Legal Executives (ILEX) and its regulatory arm, ILEX Professional Services (IPS), supported much of what the LSB was seeking to achieve. But the joint submission was clear that “[f]lexibility to

¹⁴ Statutory regulation, rather than self regulation or no regulation.

enable the Approved Regulators to establish their regulatory arms and together define their relationships in such a manner as they see fit should be the appropriate approach”.

- 4.14. Approved regulators without representative functions will need a particular degree of flexibility. The submission from the Faculty Office on behalf of the Master of the Faculties suggested that the rules made by the LSB should not apply to it as an approved regulator. There would be no justification, it argued, for extending IGRs beyond those bodies where there is a need to separate regulatory from representative functions. While the wording of section 30 is clear (IGRs must apply to each approved regulator¹⁵), there is clearly no need for treating bodies without representative functions in the same way as bodies that do.

The LSB concludes that:

- the concept of ring-fencing is sensible and should be retained. Those responsible for discharging regulatory functions should be recognised by the profession and the public as having that responsibility;
- there should be sufficient flexibility for approved regulators to apply the principles, rules and guidance set by the LSB;
- ring-fencing should see the delegation of all regulatory functions performed by approved regulators, subject to necessary residual oversight;
- the framework created should be designed to hold the confidence of consumers, lawyers and the public – and certainly not to exclude any one or more groups; and
- while the rules will need to apply to each approved regulator, those without representative functions should not be unduly burdened by such application.

Questions 2 and 3 – Regulatory appointments etc

- 4.15. In paragraph 3.15 of the consultation paper, focus shifted to issues of specific detail concerning the board-level appointment, reappointment and appraisal for regulatory arms. The proposals suggested that regulatory appointments should be made on merit so as to achieve an in-built majority of non-lawyers; there should be no requirement for board chairs to be legally qualified; appointment panels should be demonstrably independent of representative control; and objective appraisal mechanisms should be established.
- 4.16. Question 2 asked for views on the proposals set out at paragraph 3.15. Question 3 asked whether proposals needed to go further, for example by making an explicit requirement for lay chairs.

¹⁵ See wording of Legal Services Act 2007, section 30(2), which requires “each approved regulator to have in place arrangements which ensure” no prejudice from representative functions.

Strong [bodies] that are clear their overriding purpose is the public interest are essential to effective regulation, particularly if they operate alongside established professional representative bodies. Independent appointment of members against defined competences, robust appraisals of members and established complaints and disciplinary procedures are all important mechanisms for ensuring boards remain focussed on the public, and not sectional, interest.

Council for Healthcare Regulatory Excellence

- 4.17. Many respondents raised issues not explicitly covered in the consultation proposals. For example, several submissions suggested that regulatory boards should be composed so as to ensure equality and diversity issues are fully recognised. Several submissions pointed to the lack of any explicit requirement in the consultation proposals prohibiting people with representative functions being appointed to a regulatory board. The LSB agrees that both issues are important.
- 4.18. From outside the sector, the Council for Healthcare Regulatory Excellence (CHRE) shared the three principles which guide appointments to the bodies that it oversees:
- board membership must reflect the interests and concerns of all parties with a stake, although board members must be clear that they are in place to protect service users and the public, rather than ‘representing’ any interest group;
 - defined criteria should ensure that, as a whole, a board possess the necessary attributes to set strategic goals and effectively scrutinise delivery of them; and
 - bodies should aim to achieve a regular turnover of members in a managed and staggered fashion to ensure stability and continuity.
- 4.19. With two caveats, the proposals that were set out won support from all respondents answering the question. The caveats, however, are important. First, a range of opinions was expressed on the desirability of requiring in-built non-lawyer majorities for each regulatory board. Linked to that was the question of non-lawyer chairs. Here, most respondents tended to agree that there was no need to *require* lay chairs under rules. Second, opinion was divided on the question of who should control the appointments process.
- 4.20. **Lay majorities.** Some respondents (roughly a third) urged the LSB to retain the proposed requirement for regulatory boards to have non-lawyer majorities. A broad church including the three consumer bodies, the OFT, CPS, Council for Licensed Conveyancers (CLC) and Irwin Mitchell LLP considered that the assurance provided by a lay majority would bolster public confidence in the integrity of the framework. The Devon and Somerset Law Society said “that to

command public confidence, it is essential that a majority of the board should at all times be non-lawyers. Self regulation is thought to be no longer credible". The LSC said that a board "consisting of individuals who are in the main from the same industry creates a perception that consumers are not at the heart of regulation". This was a powerfully expressed sentiment and was the consensus view of respondents in this group.

- 4.21. A majority (just over half) of respondents urged the LSB to abandon the proposed requirement. However, there was no consensus among this group as to what (if any) rule should replace it; or as to the underlying rationale.
- 4.22. Some, like the Bar Standards Board (BSB) and the Legal Services Ombudsman/ Complaints Commissioner empathised with the public confidence argument but considered a rule to *mandate* a particular outcome was inappropriate. Instead, approved regulators should be left to appoint the best people for the job, with a clear view that the best balance is likely to favour a lay majority. Others, like the Berks, Bucks and Oxfordshire Law Society suggested rules should require a 50/50 split. A substantial number suggested that there was no reason why lawyers should not form the majority – although most accepted that rules should at least provide for a significant number of lawyers and non-lawyers on respective regulatory boards.
- 4.23. As to underlying rationale, many lawyers and professional/representative bodies made the point that lawyers should not be regarded with suspicion. So long as they can demonstrate an absence of representational interest, the skills they bring to a board table could be extremely valuable. Similarly, many submissions pointed to the value of non-lawyer membership. Experience showed that fresh perspectives from other sectors were a significant advantage and that boards tended not to divide along lawyer/lay lines. A small minority seemed opposed to the very idea of non-lawyer involvement. One solicitor respondent suggested "that requiring the majority of the regulatory board not to understand the profession they are regulating seems extremely unlikely to promote the public good".

Whilst I have empathy with the view of the board being constituted with an in-built majority of non-lawyers, I wonder whether this is an essential requirement if the board is appointed openly. I would be looking for a board to have a broad range of skills, knowledge and experience, and believe that lawyers from other backgrounds (e.g. barristers on the board of the approved regulator for solicitors) could add considerable value to the regulatory boards of the various strands of the profession. A concern to have a non-lawyer majority may mean valuable skills are lost to accommodate a reasonable sized board that is not unnecessarily large to be workable.

Legal Services Ombudsman/Complaints Commissioner

- 4.24. The debate between respondents exposed a general point of great importance. Regulatory boards need a mix of members, each bringing with them a set of skills that combine to produce a high quality team with strong strategic perspective. Lawyers cannot and should not be excluded. Proposals never suggested otherwise. Their perspective brings an understanding of the market and its drivers; of the way in which lawyers' duties to clients, the court and the wider public good operate and relate to each other; and of how and where dangers arise – and how they can best be mitigated/avoided. Significant lawyer involvement also helps to give the profession confidence that it is regulated appropriately.
- 4.25. By the same token, significant non-lawyer involvement is important, both in reality and perception. Non-lawyer (by which we do not mean “a collection of the great and the good”, as one respondent framed it) can bring significant expertise from other sectors of business and industry; of best practice in regulation and corporate governance; of consumer affairs; and of challenging assumptions. From the evidence we have seen, significant non-lawyer involvement also gives consumers and the public assurance that regulation is applied and enforced objectively and robustly.
- 4.26. A persuasive submission from a member of the Law Society Council suggested that it was hard to argue that a desire to achieve the best possible mix should start from the premise that either lay or lawyer members should be in the majority. What is vital is that the board should be appointed on merit. The composition of the board should be balanced with care to include a wide range of experience and expertise. The submission continued that it “is unhealthy to perpetuate a myth that lawyers are somehow ‘of a kind’ and that non-lawyers are the only people who the public can rely on to check any all too human tendency to self-interest. The correct balance can only be determined by the selection panels involved who have the full range of candidates in front of them”.
- 4.27. **Lay chairs.** No respondent argued that rules should require a lay chair. However, the BSB Consumer Panel did suggest that the chair should not be a lawyer regulated by the approved regulator in question. Some respondents suggested that their view on lay chairs was contingent on a lay majority being secured. The broad consensus view was, though, that chairs of regulatory boards should be appointed on the basis of merit after open and fair competition.

[[It is [not] necessary to make an explicit requirement that the chair of a regulatory arm be a non-lawyer... It is likely that the regulatory boards will choose to have a non-lawyer chair, but they should not be required to do so.

Bar Standards Board

- 4.28. The Legal Services Policy Institute suggested that to disqualify people who qualified as lawyers but who have since pursued careers in academia, industry or otherwise, would be counter-productive. This opens up the debate about how a

lawyer, or a non-lawyer should be defined; and whether the LSB should use its rules or guidance to entrench those definitions. Few submissions dealt with the issue in any depth, although the BSB considered that the LSB should address the issue. In anticipation of Legal Disciplinary Practice implementation, the BSB suggested that “lawyer” should embrace all those who are part of the regulated cohort of lawyers. “Non-lawyers” by contrast would be people who were not part of that regulated community.

- 4.29. The LSB is persuaded that there should be no requirement for a lay chair. Nor does it think that there should be any requirement for a legally-qualified chair. The best person, whether lawyer or lay, should be appointed. However, the public confidence issue is important. Looking at the range of responses received, it is clear that this is an important issue of principle. It is right that regulatory boards should demonstrate that they have sufficient knowledge of day-to-day practise in the sector to command the confidence of the regulated community. But it is also essential to demonstrate a commitment to putting consumers at the heart of the system. The proposal in respect of lay majorities, therefore, should remain¹⁶.
- 4.30. **Control of process.** Many of the same arguments employed in the wider ‘ring-fencing’ discussion under Question 1 also featured in relation to ‘ownership’ of the appointment process. The consultation paper had suggested that regulatory arms should themselves be responsible for appointments to their boards. That suggestion did not receive *universal* support, although the principle that any process must itself respect the need for independence from representative functions got near it.
- 4.31. The Law Society, among others, argued that delegating lead responsibility for the appointment process was unnecessary to ensure independence. A process managed by the approved regulator in compliance with LSB scheme should insulate the regulatory board from any undue influence. The Society also argued that it is bad practice for responsibility to rest with the regulatory arm: “it would be wrong for those who might have a vested interest in the status quo to have lead responsibility for determining those matters”. The strength of this point is unclear. Regulatory arms might well be seen as having a “vested interest”. Approved regulators might be seen as having an equal and opposite interest, a point not noted in the submission.

¹⁶ It is worthy of note that the General Medical Council is established with 50% of its members from the medical community and 50% from a non-medical/lay background. That constitutional structure is fixed by statutory instrument (SI2008/2554). The legal services sector does not have the natural insulation of institutional separation along the lines of the General Medical Council and the British Medical Association. Accordingly, a lay majority on regulatory boards will help to establish in the minds of the public an assurance that consumer focus remains a priority.

The Bar Council considers that the correct legal answer is that the composition of committees and boards [including appointments panels] is a matter for the discretion of the regulatory arm who will seek to select the best person for the job.

The Bar Council

4.32. Many respondents did want to see LSB rules requiring regulatory arm ownership of the appointments process. Among them were the consumer organisations, Which? and Consumer Focus. Again, public trust and confidence lay at the heart of arguments put. Elaborating on the theme, the LSC said that panels charged with appointments should be independent of representative arms, but that those with representative functions should not be wholly excluded from the process.

The LSB concludes that:

- the CHRE's three guiding principles¹⁷ for appointments form a sound basis for any guidance issued by the LSB (namely that board members should reflect the interests of all, rather than acting as sectoral representatives; that board members should be appointed so as to ensure the resulting board has requisite range of skills and expertise; and boards should have regular turnover but managed to ensure stability and continuity);
- although persuaded that there should be no restriction as to the appointment of regulatory chairs, the LSB remains of the view that a lay majority on regulatory boards is fundamental to ensuring the confidence of the public is held;
- just as important, however, is that *all* members who are appointed must have appropriate and sufficient experience and expertise, for example in matters of regulation. The principle of appointment on merit against a robust competency framework must also therefore be met;
- 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 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; and
- it would be helpful for the LSB to define what it means by a non-lawyer (and will seek to do so using the Legal Services Act's definition of "lay person") although approved regulators should be free to define what "lawyer" means in this context for themselves.

Question 4 – Control and management of resources

4.33. The consultation paper proposed that regulatory arms should have access to the resources reasonably required for meeting the strategy they determine. The paper suggested that strong internal governance could avoid the need for significant

¹⁷ The Council for Healthcare Regulatory Excellence: see paragraph 4.18 above.

LSB intervention, so incentivising approved regulators to establish fair and transparent mechanisms that safeguard regulatory independence.

- 4.34. 'Resources' was a term explicitly defined as much more than cash flow, although money was inevitably a crucial factor. More widely, the paper was based on a presumption that approved regulators and their regulatory arms would adopt a shared services model, with centralised provision of finance, IT, HR and similar functions. Paragraph 3.22 set out a list of factors which were designed to safeguard regulatory independence within such a model and Question 4 asked for views on those suggested factors, and our proposals on resource management more widely.

What is being proposed here is potentially a bureaucratic nightmare with the potential for increased costs and creating conflict where currently none exists.

Berks, Bucks and Oxfordshire Incorporated Law Society

We agree with the Board's proposals, and believe that they will encourage a proper balance to be struck. The Institute particularly support the notion of an independent forum to resolve resource issues.

Legal Services Policy Institute, College of Law

- 4.35. Of the 40 respondents, nine chose not to answer this question, or expressed no firm view as to the proposals outlined by the LSB. Of the remaining 31, 19 were broadly in favour of the proposals as outlined, with 15 of those expressing strong support. Twelve respondents highlighted broad concerns, with five submissions suggesting that the LSB proposals went well beyond the requirements of legislation.
- 4.36. In terms of the spectrum of respondents, those broadly in favour came from a range of backgrounds and perspectives. Those wholly or partly opposed came from a much narrower group. Issues that tended to arise were grouped around the budget settlement process and 'shared services' arrangements.

(A) Budget Setting

- 4.37. Most submissions focused on the requirements of the legislation. As in other areas, debate then centred on the correct interpretation of that legislation, with a range of views being offered. One respondent warned of "the risk of challenge to [the LSB's] vires if it exceeds its legislative authority", which another flatly rejected.
- 4.38. The perspective of approved regulators and regulatory arms was particularly interesting. While both sets might be described as having a vested interest, each approached the issues from their respective positions clearly and helpfully. As an

example, the submissions of the Law Society and the Bar Standards Board illustrate how the different strands of argument can be married together.

- 4.39. **The Law Society.** The starting point is the Legal Services Act. Section 30(3)(a) requires, in effect, each approved regulator “to take such steps as are *reasonably practicable* to ensure that it provides such resources as are *reasonably required* for or in connection with the exercise of its regulatory functions”. Indeed, the Society traced the origin of this provision to a suggestion it made when giving evidence to the Joint Committee scrutinising the Government’s draft Bill.
- 4.40. The Law Society says that the obligation imposed on approved regulators is not unqualified. There are two objective tests, namely that steps need only be taken if they are reasonably practicable (a balance of perceived benefit and cost); and whether the resources are reasonably required (required that is, in fact, rather than in the opinion of the regulatory arm). The Law Society says that the answer to both tests is for it, as approved regulator, to determine, rather than for its regulatory arm, the Solicitors Regulation Authority (SRA).
- 4.41. The Law Society suggest that a regulatory arm should propose a budget and then the mechanism put in place by it, as approved regulator, should determine whether that proposed budget is approved. The Society viewed as inconsistent with the 2007 Act any suggestion that regulatory arms should fix their own budgets. Furthermore, no such mechanism is necessary for the purposes of securing an effective independence, because irrespective of the budget-setting process, a regulatory arm always has recourse to the LSB if it (the regulatory arm) thinks it is being dealt with unfairly.

If the approved regulator were to provide a budget for the regulatory arm which was in the Legal Services Board’s view inadequate to meet its reasonable needs, the Legal Services Board would have the power to set higher practising fees than those proposed by the approved regulator, and if necessary to direct the approved regulator to provide its regulatory arm with a higher budget. Responsibility for setting budgets should thus rest with the approved regulator, not with the regulatory arm.

The Law Society

- 4.42. **The Bar Standards Board.** The BSB also used as its starting point the 2007 Act. After setting out the provision in section 30(3)(a), the BSB argued that the determination of whether resources are reasonably required must reflect the key principle of separation of functions. It is, argued the BSB, for those discharging the regulatory functions to set their regulatory agenda without interference from representative interests. When assessing reasonableness, an approved regulator must be limited to considering the level of resources necessary to meet the objectives as set by its independent and ring-fenced regulatory arm: “[i]t is not for the AR to seek – through provision of resources – to limit or change the regulatory objectives set by those discharging the regulatory functions”.

- 4.43. The BSB accepted that a regulatory arm must account properly for the sums it spends and budget properly for the sums it expects to need. This process would form an essential part of setting the practise fee level, which would ultimately be approved by the LSB.
- 4.44. In practical terms, the BSB argued that the issues of resourcing broke down into three areas, namely money, staff management and information. While the latter two areas more appropriately fall within the shared services debate (see from paragraph 4.46 below), the issue of money clearly falls within the budget-settlement area. The BSB's line was simple: LSB rules should require approved regulators to have in place a budget-settlement process that does not subordinate the needs of the regulatory arm to representative interests.

[A] regulatory arm cannot require an AR to fund 'Rolls-Royce' delivery of every single one of its strategic objectives. For its part, the AR must recognise equally that it cannot cut the regulatory arm's budget in a way which prevents it from delivering its main priorities just because those priorities are not welcomed by certain sections of the regulated community. Somewhere between those extreme and hypothetical positions is the correct way forward, which rests on open and practical co-operation between the regulatory and representative arms.

Bar Standards Board

- 4.45. The natural checks and balances that the combined Law Society/BSB approach brings are sensible. Internal mechanisms designed to test value for money, but which do not prejudice or otherwise damage regulatory independence must be a necessary part of good governance. More widely, approved regulators and regulatory arms urged the LSB to be flexible. In particular, the LSB should avoid prescribing detailed processes where unnecessary. The principles derived from the analysis of submissions have helped to develop LSB thinking here.

(B) Shared Services

- 4.46. A number of submissions took the trouble to summarise the benefits made possible by corporate shared services and the economies of scale they can bring. Having recognised and accepted the advantages generally associated with shared services, the LSB set out proposed independence safeguards at paragraph 3.22 of its consultation paper. Proposals included establishing objective and fair management arrangements, including to cater for any issues or disputes arising between those accessing the shared services; and clarity over line management for members of staff.
- 4.47. For the SRA, an important issue of principle was that regulatory arms should have full control over its resources (capital, current expenditure and human resources)

within its agreed budget. Insofar as corporate services, it went on to distinguish “shared services” from “imposed services”, arguing that regulatory arms need to be more than mere consultees, but genuine players at the decision-making table where issues of service management are concerned.

- 4.48. The SRA agreed with the proposals as set out at paragraph 3.22 of the consultation paper. Although it considered a ‘dispute resolution forum’ to be too narrow in scope, it was supportive of the need for a mechanism to run shared services between regulatory and representative arms.
- 4.49. Other approved regulators were wary of the level of detail included in the proposals. The joint submission filed on behalf of ILEX and IPS suggested that paragraph 3.22 “goes beyond the minimum required except by way of guidance”. The two intellectual property Institutes and their joint regulatory arm expressed similar reservations. The sentiment behind these submissions was almost to label the LSB’s proposals as giving way to ‘Model A creep’, i.e. stepping away from the Model B+ recommended by Sir David Clementi and unduly restricting the ability of approved regulators to apply LSB principles in the best way for their sector.
- 4.50. The Bar Council’s submission highlighted concern over the LSB’s proposals in respect of line management of staff. As approved regulator for the barrister profession, the Bar Council employs a number of staff. Some members of staff are deployed under the auspices of the BSB, its regulatory arm, but it remains legally responsible for those staff as employer. The Bar Council was concerned that LSB proposals should reflect that fact.
- 4.51. Of course, interest in these proposals went wider than the approved regulator community. But the submissions from approved regulator (including regulatory arm) respondents covered the broad range of issues raised elsewhere, albeit articulating those points in different ways to some of the other respondents. Moreover, as the proposals apply exclusively to the approved regulators, it was important to set out the views expressed by that community.

The LSB concludes that:

- it would be wrong for regulatory arms to set their own budgets without oversight or challenge, but it would be equally wrong for approved regulators effectively to veto proposed strategy by withholding necessary resources;
- accordingly, approved regulators should establish mechanisms where regulatory arms can propose their own budgets. Subsequent scrutiny should be limited to assessing the reasonableness of the resources required in order to meet the regulatory strategy. That strategy should itself be established in accordance with statutory duties and so should be reasonable;
- there is nothing wrong with the same corporate hub – or commonly sourced outside supplier – providing services to both regulatory and representative arms. However, such arrangements need to be flexible enough to enable different types and/or standards of service to be provided to the different wings to reflect differing business needs;

- therefore, approved regulators should agree with their regulatory arms the service standards necessary to pursue the latter's regulatory strategy. If shared service standards cannot be agreed and the budget process does not give sufficient resources for the regulatory arm to purchase services elsewhere, the LSB will be able to rely on its formal enforcement powers; and
- while it might not be necessary to insist on independent oversight boards to manage shared service provision as originally proposed, the processes developed by the approved regulators should comply with the IGRs and the LSB will reserve the right to direct the body to put in place particular mechanisms, if independence or effectiveness is being (or is likely to be) prejudiced.

Question 5 – Balancing rules and guidance

- 4.52. At paragraph 3.24, the consultation paper suggested that the rules eventually made by the LSB should be pitched as a high level of principle, rather than dealing with too much in-depth detail. The proposed rules to be made by the LSB were set out in Chapter 5 of the paper. The substance of Chapter 3 was described as providing the basis for guidance to be produced under those rules. Question 5 asked respondents whether the proposed balance between rules and guidance was appropriate.
- 4.53. The majority of respondents either chose not to answer this question or gave no clear view on the question of the proposed balance. However, the broad consensus view was that some balance between principle-based rules and supporting guidance would be helpful. Dissenting from the consensus view, John Adams suggested that the use of informal guidance encourages a lack of proper intellectual rigour in making the underlying rules.

The balance between rules and guidance seems broadly workable. However, it is possible that problems may arise in the future, either in terms of interpretation of the principles or in terms of enforcement. Across sectors, we have given a cautious welcome to principles based rules... [T]he Legal Services Board should not shy away from making future revisions to its rules where necessary, especially if there is a need for more clarity up front.

Which?

- 4.54. Of the 20 respondents who expressed a firm view, 14 either supported the proposed balance between rules or guidance (10) or wanted the LSB to transfer some of the guidance into more formal rules (four). Six respondents expressed a concern that the draft rules included too much detail and proposed shifting some of that detail to the underlying guidance.

- 4.55. Some respondents urged the LSB to clarify the relative status of proposed rules and guidance. For example, the CPS noted that proposed guidance would be “non-enforceable” but questioned how far a failure to follow guidance would be considered when deciding whether a formal rule had been breached.
- 4.56. This was an issue that the LSB returned to at the stakeholder event held on 29 July. In the paper sent to workshop invitees, the LSB suggested that:
- the LSB, as a principles-based regulator, will seek to manage from a set of principles that flow from risks to regulatory objectives rather than from change to the status quo;
 - underneath the broad principles identified and set out, certain rules will be made which require approved regulators to act in a particular way or in one of a number of ways to achieve a determined outcome. Rules made by the LSB would be backed by the enforcement powers open to the Board; and
 - illustrative guidance would support those rules, and approved regulators must have regard to that guidance when seeking to comply with the specific rules and overarching principles (representing the spirit of the rules). In general, the less that guidance is observed by an approved regulator, the more the LSB will look to monitor and scrutinise performance.
- 4.57. A number of specific suggestions were made by respondents about provisions necessary in either rules or guidance. Those observations are summarised under Question 17, below.

The LSB concludes that:

- what those required to comply with rules need is clarity. The LSB proposes to set clear *principles*, which must be adhered to, *rules* which describe how a principle should be adhered to in the comparatively few cases when the LSB believes that only one method of compliance is acceptable, and *illustrative guidance*, which approved regulators should take into account when seeking to comply with principles and rules; and
- the scheme of principles, rules and guidance developed here will be consistent with other sets of statutory rules which the LSB is currently consulting on.

Question 6 – Scrutiny and monitoring

It is a feature built into the very fabric of the Act that the AR monitors and supervises the work of the regulatory arm.

The Bar Council

- 4.58. Paragraphs 3.25 to 3.39 of the consultation paper outlined proposals in respect of the supervision by approved regulators of their respective regulatory arms. The paper explained that, irrespective of any delegation of functions, the statutorily designated approved regulators must always remain ultimately responsible for the discharge of their functions in accordance with the requirements of the Legal Services Act and more widely. Regulatory independence requirements must respect that fact, but so too must the spirit of regulatory independence be respected.
- 4.59. The paper's proposals were built on the principle that "it should be absolutely clear that regulation is not to be controlled [or unduly influenced] by people who also carry out representative functions and so who could (wittingly or unwittingly) act in a way that is wholly or mainly in the profession's interest"¹⁸. More specific proposals followed on the extent to which intervention and monitoring activity would be considered appropriate. Question 6 then asked for views on the suggested oversight role as proposed.

[T]his is one of the most difficult issues for the LSB to deal with in a manner which is proportionate, but which ensures compliance with the requirements of the Act for the Approved Regulator to act in accordance with the regulatory objectives and the principles of better regulation.

Chartered Institute of Patent Attorneys

- 4.60. Few respondents (five at most) rejected the basis on which LSB proposals had been developed. A much larger number (around 17) expressed broad support for the principles set out in the paper. A similar number were hard to categorise, or did not answer the question at all.
- 4.61. Looking at submissions across the board, it was possible to identify certain common themes. First, many of the views expressed in response to other questions also featured here. Themes included:
- the need for a framework that instilled public confidence, which can be helped in large measure by maximising transparency;
 - the dangers of being seen to exclude the profession from the issues affecting its regulation; and
 - a recognition that flexibility is important if approved regulators are to implement and embed genuinely effective processes underneath the requirements set by the LSB.

¹⁸ See *Regulatory Independence* consultation paper, paragraph 3.26.

- 4.62. There were also many points made of more specific application. Chief among them was what bodies like the Bar Council, BSB, ILEX/IPS, CIPA, ITMA, IPREG¹⁹ and others labelled as the need for an atmosphere of mutual respect, co-operation and constructive relationships.
- 4.63. One respondent, Sue Nelson, summed up the views of many respondents. What is most important is not the terms of the separation in these areas but arriving at a shared understanding of the principles that underpin them. Neither party should need to resort to rules or regulations but should willingly work well within their scope.

To be effective the regulation of [lawyers] needs to be based upon a shared understanding between regulator and regulated. I use the word understanding with particularity because I do not mean 'agreement'. While agreement is often highly desirable it is not always possible to achieve, hence the need for appeal to the LSB. If the regulator and regulated are to achieve the nirvana of shared understanding they need to work in a way which enhances the exchange of information.

Sue Nelson

- 4.64. At approved regulator level, each branch of the profession (AR and regulatory arm, where they responded) agreed broadly on the mechanism that would work best in their particular context – and no one mechanism mirrored exactly that of any of the others. In order to succeed in creating an effective and workable system, respondents cited the need for internal co-operation and understanding, rather than for detailed rules from the LSB prescribing what internal mechanisms should or must look like.
- 4.65. Broadly, each of the approved regulators (including regulatory arms) agreed that the body designated by statute as approved regulator has a duty – which is not a one off duty but a *continuing* duty – to secure proper performance of regulatory functions and to protect regulatory independence. As ever, achieving the appropriate balance was the issue. Issues of detail would need to be considered (on the basis of the rules eventually made) as and when approved regulators seek to self-certify compliance in respect of their specific arrangements.
- 4.66. Although it is possible to describe a broad consensus along the lines of the previous paragraphs, some respondents were more critical of the consultation paper's proposals. One respondent, Peter Adams (with whom Sue Nelson and Jeffrey Forrest tended to agree), suggested that the consultation's drafting displayed a "prejudice" wholly unsupported by evidence. He said that the LSB appeared to take the view that solicitors (who have been trained to balance

¹⁹ CIPA, ITMA and IPREG are, respectively, the Chartered Institute of Patent Attorneys, the Institute of Trade Mark Attorneys (which are two of the eight approved regulators) and the Intellectual property Board (the joint regulatory arm for CIPA and ITMA).

competing interests) are less able than other directors to understand the legal and factual distinctions between professional and public interest.

The last clause of paragraph 3.26 (“and so who could (wittingly or unwittingly) act in a way that is wholly or mainly in the profession’s interest”) is one that I hope the LSB will withdraw. The “wittingly” suggests that the Law Society, staffed in part and led by solicitors whose continuing ability to practice depends upon their integrity might, with intent, disregard the law. “Unwittingly” suggests incompetence.

Peter Adams

- 4.67. As explained in paragraph 3.19 of this response document, the LSB was disappointed that its proposals were capable of such negative interpretation. In particular, proposals were not designed whilst looking solely at one of the eight approved regulators (or the branch of the profession it oversees) in a vacuum. Proposals will apply across the board.
- 4.68. Despite the strong representations of a minority, the LSB does not believe that it should discount evidence in respect of public or consumer perception because that has a direct bearing on the confidence which the public and consumers have in the regulatory framework. Levels of confidence affect decisions people take and so the dividing line between perception and reality becomes a red herring. But the confidence of the profession is also important. As Sue Nelson put it: there always needs to be a shared understanding between regulator and regulated. Shared understanding will never be achieved by excluding or marginalising lawyers. Nor was it ever the intention of the LSB to exclude or marginalise any group of stakeholders. Again, an appropriate balance needs to be achieved. The basis of that balance needs to be understood by all.

The LSB concludes that:

- constructive relationships, built on a shared understanding, are important. But regulatory capture should always be guarded against;
- in creating supervision and monitoring arrangements, approved regulators must act proportionately. In particular, the LSB’s proposed compliance/enforcement escalation policy means that regulatory action can be predicted long before it is taken. Therefore there is no need to design and operate arrangements to mitigate risks that, practically speaking, cannot yet arise;
- the importance of public confidence should not be under-estimated. Clear and transparent processes, operated in accordance with the spirit of regulatory independence must be firmly in place; and
- the LSB continues to believe that the principles set out in its consultation paper (see paragraphs 3.25 to 3.30 inclusive) remain valid. While the scheme of the rules should afford more flexibility than perhaps initially proposed, the underlying principles must be met.

Questions 7 and 8 – Dual self-certification

- 4.69. Paragraphs 3.40 to 3.44 of the consultation paper considered the issue of compliance with the proposed rules. The paper suggested that the obligation imposed by statute on the LSB was not simply to make rules, but to ensure approved regulators complied with those rules once made. The issue for the LSB was how it should assure itself that compliance was satisfactory, whilst also respecting the need to be proportionate.
- 4.70. In summary, proposals suggested that once rules had been made requiring approved regulators to establish their own internal arrangements, the LSB should approve those rules (allowing them to have effect) and then monitor effective compliance thereafter. In terms of on-going scrutiny, the mechanism proposed was called “dual self-certification”. Questions 7 and 8 sought views on the proposed model, first as to suitability then as to how it should work in practice.

In principle, we consider that this is a robust, fair and proportionate method of identifying issues of possible non-compliance with the rules.

Solicitors Regulation Authority

General level of support

- 4.71. A quarter of the 40 respondents expressed no view as to the appropriateness or otherwise of the LSB’s proposals here. Of the remaining respondents, all were broadly supportive. However, five respondents suggested that the ‘dual’ aspect of dual self-certification should be omitted.
- 4.72. Insofar as the ‘dual’ aspect is concerned, the rationale of the five respondents who favoured its removal was broadly consistent. Parliament, it was said, has made approved regulators responsible for the exercise of their regulatory functions. That includes in respect of complying with the Legal Services Act generally and with the IGRs in particular. As it is the approved regulator which must answer to the LSB for compliance with its rules, adding a requirement for a regulatory arm to be involved is unnecessary. Indeed, as the regulatory arm has an automatic and entrenched right to raise issues with the LSB as and when it likes, the dual-certification affords no additional benefit or protection.

The Society supports the concept of self certification by the approved regulator, but does not consider it appropriate for the regulatory arm – which is not directly responsible for making the arrangements – to certify compliance.

The Law Society

4.73. Arguing from a different perspective, the Bar Standards Board's Consumer Panel suggested that the dual approach was likely to be effective and proportionate. The submission went further and suggested that, where approved regulators have a consumer panel, that panel should itself have a role in the certification process. The premise of the argument was that consumer panels are likely to be in a good position to observe and comment on the arrangements in place. The LSB was therefore encouraged to provide, when building its framework, for such views to be fed in.

4.74. The rationale underlying the LSB proposals was threefold:

- (a) to help approved regulators review the arrangements for which they are responsible and provide the evidence in order to demonstrate compliance;
- (b) to provide the LSB with assurance that its rules are being met; and
- (c) to provide a transparent process so that the wider world (including lawyers and consumers) are reassured as to the integrity of the framework.

4.75. It is likely that a certification process involving both approved regulators and regulatory arms (and perhaps, where they exist, organisations like consumer and/or practitioner panels) would be more robust and effective. It is also likely that such a process would be perceived to be more robust and effective. In a way, excluding regulatory arms from the process would render pointless the idea of having the process in the first place. It is the check and balance fostered by the dual nature of the process that provides the mechanism which best demonstrates compliance. Without a *pro-active* duty on the respective parts of an approved regulator to certify compliance and be accountable for that certification, it is likely that significantly more scrutiny would be required to assure the LSB that its rules were being met.

Practical arrangements

4.76. Many respondents suggested that, if a self-certification model was adopted, it should be made clear that the process would be part (albeit a central part) of an assessment toolkit, rather than the sole method of engagement between the LSB and approved regulators/regulatory arms. That must be right. At least insofar as regulatory arms are concerned, the Legal Services Act entrenches a right to communicate direct with the LSB, so any unresolved concerns could and should be flagged immediately.

4.77. Other commonly suggested ideas included a requirement for certificates to be published and that the certification process should be managed in the context of any wider review process. Insofar as transparency is concerned, the LSB welcomes the commitment of approved regulators in this regard. In respect of the wider review process, it would seem sensible – and proportionate – to manage any processes together so as to minimise time spent by the LSB and by respective approved regulators.

[W]e are attracted to the model that would make the annual dual self-certification a part of the general review arrangements in place for each Approved Regulator that would be undertaken by the LSB. This would be proportionate, placing significant responsibility on the Approved Regulator and its regulatory arm... Clearly, neither party would want to wait for problems to happen, and therefore use must be made of existing and on-going forms of communication.

ILEX and IPS

- 4.78. There were some calls for the LSB to ensure that the process it establishes will be robust enough to provide the assurance necessary in such a key area. In its submission, Consumer Focus suggested that there could be circumstances when both arms of the approved regulator think that they have complied with the rules but the LSB disagrees. It will be necessary, argue Consumer Focus, for a process to be in place to evaluate the self-certification. This process should include a facility for other interested parties including the LSB's Consumer Panel to raise concerns.
- 4.79. On the other hand, the Law Society in its submission doubted that it would often be necessary or proportionate to look behind the certification process. The Society suggested that such action would only be needed in the event that the LSB had concerns about the independence of a regulatory arm from the professional body.
- 4.80. Four submissions also pointed to compliance templates in the wider world of industry, which draw on regular training (with evidence of attendance), a personal certification by senior managers and a confidential hotline for whistleblowers.

The LSB concludes that:

- dual self-certification is likely to be both proportionate and effective. It therefore remains a key plank of the LSB's proposed assurance process;
- in terms of mechanics, approved regulators and regulatory arms will be required to certify compliance with the rules, using a template prepared by the LSB. That template will require the signatories to demonstrate how arrangements adhere to the LSB's principles, meet the rules and take account of any guidance; and
- while it might not always be necessary to "look behind" the certification process, the process established must allow proportionate scrutiny. What is proportionate may be determined (among other things) by the extent to which guidance offered by the LSB has been taken in account.

Questions 9 and 10 – “Permitted purposes”

- 4.81. Section 51 of the Legal Services Act requires the Board to make rules about the purposes for which approved regulators may apply funds raised through mandatory practising fees. Section 51(4) provides that six purposes must be specified in the rules made by the LSB. The LSB can then provide for additional ‘permitted purposes’ if it determines that it is necessary or desirable.
- 4.82. Paragraphs 4.6 to 4.9 of the consultation paper explained the provisions of the Act and outlined its proposals in respect of them. As well as making rules to cover the statutory permitted purposes, the LSB suggested that it was necessary to include specific mention of regulatory objective (g) – increasing public understanding of the citizen’s legal rights and duties – in the permitted purpose rules. Question 9 asked whether respondents agreed with the proposal in respect of regulatory objective (g). Question 10 asked whether there was a need for any other permitted purpose(s) to be specified in the rules.

Increasing public understanding

- 4.83. Fourteen respondents expressed no view. Twenty one respondents expressed support (often strong support) for the LSB proposal. Some of those respondents suggested that while it was right for the LSB to make the rule, it should be for approved regulators to determine how (if at all) the discretion to apply funds to such a purpose was exercised in practice.

Because public legal education (PLE) is one of the regulatory objectives in Section 1 of the LSA it should be taken seriously by the LSB whose duty should be to encourage the approved regulators in furthering their own PLE activities and those of their members.

Irwin Mitchell LLP

- 4.84. Five respondents were opposed to the LSB’s proposal. The CPS suggested that, although a worthwhile aim, the provision in section 51(4)(a) was already wide enough in scope to cover what was necessary. The Tunbridge Wells, Tonbridge and District Law Society submitted that this consultation proposal (among others) suggested that “the LSB wishes to undertake numerous roles which were not originally intended”. The Society said that, at present, there did not appear to be any adequate justification for broadening the remit of the LSB. The remaining three respondents said that the function of increasing citizens’ knowledge and understanding was one of public policy and so should be funded by Government, not by the profession.
- 4.85. In respect of the CPS argument, it seems from consultation responses that the degree of doubt as to interpretation of the provisions is sufficient to justify inclusion of the additional permitted purpose. The wider objections expressed cannot be valid. First, the permitted purposes have nothing whatsoever to do with what the

LSB does or does not do. Permitted purposes allow approved regulators to apply funds raised through their own practising certificate mechanisms. Irrespective of whether Parliament was correct in doing so, it has legislated to impose a duty on each approved regulator to respect and observe the regulatory objectives, which include increasing public understanding of citizens' legal rights and duties. While they have discretion in determining how to balance their responsibilities, approved regulators cannot be under a legal duty but be prevented from applying practise fee revenue in order to comply.

Additional permitted purposes

- 4.86. Thirty of the 40 respondents expressed no view (16) or expressed the view that no further permitted purposes were necessary or desirable (14). Some submissions in this category argued that the LSB should be robust in its analysis of any applications to extend the permitted purposes, because any extension could mean higher practising fees for authorised persons – which could ultimately be passed on to consumers.

We ourselves would not wish to have a general power to raise money through practice fees to apply funds to measures which those regulated might question.

Intellectual Property Regulation Board

- 4.87. The remaining 10 respondents did make various suggestions as to how the permitted purposes could and should be widened. Suggestions made included:
- the pro bono provision contained in section 51(4)(d) should be extended to support for pro bono work generally;
 - that reference in section 51(4)(e) to the promotion of the protection by law of human rights should be extended specifically to cover equality and diversity issues;
 - the addition of a “catch all” provision to allow approved regulators to apply funds for the purpose of furthering any one or more of the regulatory objectives entrenched under section 1 of the Act and/or any of the regulatory arrangements specified in section 21; and
 - including an explicit reference to the promotion of access to justice.
- 4.88. The LSB is wary of introducing wide permitted purposes, when the full impact of such extensions is unclear. The rules made under section 51 will be capable of revision – indeed should be reviewed regularly – and so if there are significant problems with the ambit of the drafting as it stands then, on the basis of evidence, the LSB will look again at this issue.

- 4.89. On a more technical level, the Bar Standards Board submitted a supplementary response, which suggested that the provisions in section 51(4) were too narrow in certain respects. In summary, as things stand, approved regulators would be able to apply funds so as to regulate “relevant authorised persons and those wishing to become such persons” but not other persons.
- 4.90. In its case, the BSB said the barrister profession for which it is responsible includes a significant number of “non-practising barristers”, i.e. persons called to the Bar but not entitled to exercise rights of audience because they have not completed the necessary training or they have failed to renew practising certificates. Such persons are entitled to call themselves barristers and are still bound by the code of conduct. If those barristers represented a regulatory risk, the BSB said that it would need the ability to act accordingly.
- 4.91. The BSB highlighted that under the Access to Justice Act 1999, practise fees could be used for the regulation of “barristers” (which includes non-practising barristers). The BSB therefore urged the LSB to ensure that approved regulators are not prevented from applying practising fee funds in relation to such work. The LSB agrees with that suggestion.

[If] contributions to the CLC’s compensation fund are practice fees for the purpose of s.51 LSA, it follows that s.51(4) should be broadened specifically to permit payments to be made in the same circumstances as grants and associated costs are currently made out of the CLC’s compensation fund.

Council for Licensed Conveyancers

- 4.92. In addition to suggested extensions, various submissions made requests for clarity. In particular, some respondents wanted clarity over whether practise fees included contributions to compulsory indemnity/compensation funds; whether practise fees were covered if paid by individual practitioners and by entities; and whether references to “regulation” in section 51(4) included matters such as discipline and associated administrative costs.
- 4.93. In relation to:
- (a) **indemnity contributions** – 51(1) defines practising fees as a fee payable by a person under an approved regulator’s regulatory arrangements “where payment of the fee is a condition which must be satisfied for that person to be authorised”. While contributions to indemnity/compensation funds are often mandatory (i.e. must be paid as a condition of authorisation), the LSB does not consider that such contributions fall within scope of section 51. First, it is unlikely that the sum paid by way of contribution would constitute a “fee”. Second, the default list of permitted purposes entrenched in section 51(4) does not include indemnity contributions or compensation fund payments. But Parliament through separate legislative vehicles has required such sums to be

paid, at least in respect of some of the approved regulators. The omission of compensation/indemnity arrangements from the list in section 51(4) must indicate that Parliament intended the other legislative provisions to apply, rather than indicating a desire to see the LSB given a discretion over whether to allow such payments;

- (b) **entity regulation** – although section 51 refers to practising fees being levied on “persons”, the definition of person in section 207 includes a body of persons, whether corporate or unincorporated; and
- (c) **discipline** – the LSB considers that Parliament must have intended the word “regulation” used in section 51(4)(a) to include activities covered by the Act’s definition of regulatory arrangements in section 21(1). Regulatory arrangements include disciplinary arrangements and so it is unnecessary to elaborate the permitted purposes rules further. Associated or incidental administrative costs are, of course, part of the cost of that regulation. But for the administration, the regulation would have little or no effect and so would be pointless.

The LSB concludes that:

- it is right to extend the permitted purposes to provide for public legal education;
- the BSB’s suggestion about broadening the ambit of the existing permitted purposes to allow application of funds in respect of non-practising lawyers is sensible and should be incorporated into the LSB’s rules; and
- at this stage, it does not appear that approved regulators will suffer any practical difficulty if the permitted purposes are not extended further – but the LSB will consider representations made and can update its rules, as necessary, if a pressing case is made out.

Questions 11 to 13 – The practise fee approval process

- 4.94. As well as making rules to cover the ‘permitted purposes’, the LSB will be responsible for approving the level of practise fees levied by each approved regulator.
- 4.95. Paragraphs 4.10 to 4.18 set out proposals for an approval process. Issues considered included the evidence likely to be required by the LSB when considering applications from approved regulators, the criteria against which applications should be judged, and how best to tailor the requirements of the rules to the specific processes of each approved regulator. Questions 11, 12 and 13 then asked for views in each area.

Evidence

- 4.96. The consultation paper had proposed that the evidence required from approved regulators should be grounded in the Act's regulatory objectives. At least a third of respondents agreed with that broad proposition, and just over half expressed no view. The remainder disagreed with the proposition and gave very strong reasons for so doing.

We are not sure whether seeking evidence specifically linking the proposed level of practising fees to regulatory objectives will in itself do much to assist the LSB's ability to approve the level of practising fees. It could turn into a bureaucratic box ticking exercise.

Solicitors Regulation Authority

- 4.97. It was argued that regulatory strategies and business plans are what needs to link with the regulatory objectives. Those links will be subject to LSB oversight through mechanisms like the regulatory reviews proposed in the 2009/10 Business Plan. Practising fees will merely be one source of finance to fund the business plan. Accordingly, it would be unduly cumbersome for a link to the regulatory objectives to be made insofar as regulatory costs were concerned; and irrelevant for non-regulatory purposes.

Criteria

- 4.98. The Law Society, in its submission, suggested that the LSB will need to be satisfied that practising fees are sufficiently high to enable the approved regulator to resource its regulatory functions; and not too high so as to impose an unacceptable burden on the regulated community. The Society suggested, however, that it will rarely be necessary for the LSB to make its own detailed assessments about these issues. Unless there is a fear that that regulatory arms are not sufficiently independent, the LSB should safely assume that the proposed fee is neither too high (because the representative arm would not agree) nor too low (because the regulatory arm would not agree).
- 4.99. To a large extent, the Law Society's proposition must be right. Where approved regulators exercise both regulatory and representative functions, the section 30 rules (covered in the first part of this chapter) would provide the assurance mechanism for the LSB on the issue of regulatory independence. Where approved regulators do not exercise a dual role, there is unlikely to be any independence issue. With appropriate checks and balances built in to each approved regulators' internal processes, the LSB should be able to rely on receiving applications to approve a level of fees that is neither too high nor too low. The checks and balances should also deliver against value for money criteria too.

[T]he criteria that the LSB should use to assess fee applications should include:

- *adherence to the permitted purposes;*
- *how far prior year regulatory plans have been achieved and what remains to be delivered;*
- *achievement of value for money in expenditure on permitted purposes;*
- *extent to which other sources of income used to fund permitted purposes have changed or are forecast to change; and*
- *any exceptional necessary funding required as a result of legislation or unforeseen requirements.*

Bar Standards Board

4.100. That checks and balances might bring about reasonable and proportionate applications does not divest the LSB of its responsibility to consider those applications, judging them against criteria. Several respondents suggested criteria that should be applied by the LSB when considering such applications. Most commonly mentioned was adherence to the permitted purposes.

Memoranda of understanding

4.101. Respondents were generally supportive of the proposal to form memoranda of understanding (MoU) with each approved regulator, such memoranda to set out the tailored process to suit the circumstances of each body. Again, the proposals were seen as proportionate and flexible and therefore helpful to the approved regulators.

4.102. The broad consensus was that MoUs should contain the following:

- a timetable defining engagement and decision points for approved regulators and the LSB;
- the extent to which there will be any requirement for consultation;
- a definition of the internal mechanisms of the approved regulator to provide the necessary checks and balances in the application's preparation; and
- the documents that the LSB will require in order to consider the application and any particular criteria used to judge the application.

The LSB concludes that:

- the proposal to link criteria to the Act's regulatory objectives is not appropriate, for the reasons given by consultees. So the LSB will modify its proposals in this respect;
- criteria like adherence to the permitted purposes, viability in the context of proposed business plans (in the immediate financial year and those following in the medium term) and access to emergency funding as and where necessary should, instead, be used by the LSB; and
- the LSB should adopt the consensus view on memoranda of understanding, which should themselves contain tailored details as to timelines, criteria and evidence requirements.

Questions 14 and 15 – Consultation and transparency

4.103. A focus of the consultation paper was transparency, and in particular how practising fee mechanisms could be made as open and accountable as possible. Question 14 sought views on the extent to which there should be a requirement for approved regulators to consult prior to submitting a practising fee application to the LSB for approval. Question 15 asked what degree of detail should be given to lawyers about the breakdown of their practising fees when the bill is sent out each year.

Consultation

4.104. Twenty one respondents expressed no or no firm view on the topic of consultation. Eight said that there should be no requirement imposed by the LSB in respect of consultation. Thirteen respondents broadly favoured a requirement for consultation, although the majority of them (seven) suggested that consultation between the regulatory arm and the professional body would probably be sufficient in most circumstances.

4.105. Of those in favour of a consultation requirement, many suggested that the appropriate details should be agreed between the LSB and approved regulators as part of the process of settling memoranda of understanding. The general rule would be that minimal changes would be unlikely to require significant if any consultation further than professional/representative bodies – whether that professional/representative body was the residual approved regulator or institutionally separate²⁰. The greater the proposed change, the greater the case for wider consultation will be.

²⁰ Where an approved regulator has representative functions, it will usually have a representative Council which can act as primary consultee with the regulatory arm. In the two instances where an approved regulator has no representative functions (i.e. the CLC and Master of the Faculties), there are representative bodies that are institutionally separate and those organisations could act as consultees in this process.

Regulators must obviously consult interested parties and stakeholders. However the range and extent of consultation should remain a matter of judgment for the regulator. The LSB should not make any detailed rules restricting the scope of that judgment, unless and until experience should show that such rules would be really necessary or helpful.

City of Westminster and Holborn Law Society

Transparency

- 4.106. Paragraphs 4.19 and 4.20 of the consultation paper suggested that the regulated community and the wider public had a right to know what money collected through a mandatory levy would be applied to. Transparency, it was suggested, would help facilitate accountability. But proposals must be careful to respect the principle of proportionality.
- 4.107. Paragraph 4.21 set out the LSB's proposals on what approved regulators should be required to set out for each authorised person whenever practising fees are levied from them. Question 15 asked whether the LSB had got the balance between transparency and proportionality right.
- 4.108. Eighteen respondents expressed no view as to that balance, or as to the wider issues raised around transparency. Twenty respondents expressed support for the proposals outlined at paragraph 4.21 – although two of them expressed some reservation as to certain details. The remaining two respondents expressed clear opposition to the consultation's proposals.
- 4.109. Where concerns were expressed about the consultation's proposals, grounds of proportionality seemed central. The Berks, Bucks and Oxfordshire Law Society suggested that the suggested requirements would add to the bureaucracy and therefore cost money but that the cost had not yet been estimated nor analysed. The Society said that to continue without better analysis would be remiss. This might have been a minority view. But the issue of proportionality was central to many responses.
- 4.110. The Law Society, while in favour of a requirement for transparency, suggested that the LSB proposals were "over-elaborate" in certain respects. In particular, the Society did not consider it sensible to require the shared services costs to be spelled out on practising certificate bills. It suggested that it "would be more informative for authorised persons to be shown the costs of the regulatory and non regulatory work, including in each case the share of shared services properly attributable to them".
- 4.111. The clear consensus view of those answering the question was to support a requirement for transparency and to support the specific proposals set out in the consultation paper. A number of points of detail were made though. Among the suggestions were:

- including a requirement to set out funds allocated for “unpermitted activities” (as the final bullet of paragraph 4.21 does) does not seem sensible. If something is unpermitted, it should not take place. It might be more appropriate to refer to ‘activities that are not permitted purpose activities’;
- approved regulators might take this opportunity to consider the regulatory risk posed by different sets of practitioners and then transparently explain where and how this assessment has fed into the fee’s calculation for those respective sectors; and
- shared services are an area where resourcing can appear most unclear, when viewed from the outside, and so an obligation for transparency might do well to look here before elsewhere.

The proposals in the consultation paper appear sensible. So far as practicable, we would encourage regulators to report expenditure against the main areas of regulatory activity, eg rule-making, supervision, public legal education.

Consumer Focus

The LSB concludes that:

- where approved regulators themselves have representative governing councils, the need for wide consultation beyond that council should be limited unless far-reaching changes are envisaged in fee levels or in the application of the fee burden across the profession;
- where approved regulators do not have such councils, consultation might be appropriate with some comparator organisation which represents members of the particular profession, but the extent to which minor variations need to undergo far-reaching consultation is best left for approved regulators to determine; and
- transparency remains an important principle and one which the LSB proposes to require approved regulators to meet. The Law Society’s point about being over-elaborate is well made, however, and the LSB does not want to impose undue burdens. So long as it is clear where funds are to be applied to activities controlled by regulatory arms, and where not controlled by regulatory arms, the objective should be secured.

Question 16 – Practising fees: miscellaneous

4.112. Question 16 gave respondents the opportunity to raise any broader issues in respect of practising fees, which earlier questions had not touched on. Six respondents chose to do so. Of those, two points were of particular significance.

They were made, in turn, by the College of Law's Legal Services Policy Institute and the Solicitors Regulation Authority.

- 4.113. **Legal Services Policy Institute.** The LSPI highlighted the relationship between practising certificate fees levied under section 51 of the Legal Services Act and fees levied under other statutory powers. Where an approved regulator has access to income via section 51 (which is regulated – with LSB approval being required) and via other powers (which might not be regulated), the motivation might be to levy through the latter, rather than the former, to avoid scrutiny.
- 4.114. The LSPI suggested that this scenario might lead to unfairness. If a statutory power (other than section 51) was meant to provide something akin to ring-fenced funding for a particular purpose, the lack of oversight or scrutiny through a section 51-style process could mean the pool of people from whom the levy is collected pay more than necessary to fund the relevant activity. In effect, money raised would cross-subsidise other activities which would otherwise fall under the scrutiny of the LSB.
- 4.115. By way of example, the LSPI pointed to section 2(3)(c) of the Solicitors Act 1974. That provision allows the Law Society to levy fees from students. Schedule 16 (paragraph 4) of the Legal Services Act in effect makes that power unregulated. But the LSPI argue that issues such as barriers to entry apply equally here as in the general practising fee arena. The LSB should therefore seek to scrutinise this aspect of fee-raising powers so as to assure any potential loopholes in the section 51 mechanism are closed.
- 4.116. It seems to the LSB that the requirement for transparency is key. If applications for the approval of practising fees needed to include evidence of the income from other sources being applied to regulatory permitted purposes, that data would become public. The transparency would drive a proportionate and fair approach to be taken by approved regulators. The LSB agrees, however, with the argument about undue barriers to entry resulting from high fees. In the context of the current debate on access to the professions, the LSB recognises – as pointed out by the LSPI – that it has powers of direction to prevent potentially harmful exercise of fee-raising powers even where outside the remit of section 51.
- 4.117. **Solicitors Regulation Authority.** In its submission, the SRA called for clarity over where control of the practising fee process should rest when approved regulators have both regulatory and representative functions. A distinction needs to be drawn here between budget settlement processes – where consultation responses have already been summarised as concluding approved regulators have a duty to 'control' the process, albeit without exercising that control to the detriment of regulatory independence²¹ – and controlling the mechanics of the practising fee levy process.
- 4.118. Once the size of the overall budget has been determined by the approved regulator, having worked in partnership with its regulatory arm (where it has one),

²¹ See above from paragraph 4.37.

many subsequent questions will need to be addressed. Those questions will include, centrally, how to allocate the burden of the annual funding requirement among the regulated community.

4.119. The SRA suggested that the section 51 practise fee mechanism is a regulatory arrangement. Payment of the fee is a mandatory condition of being authorised to practise. In accordance with the Act, it must therefore be regulatory. As a regulatory arrangement, the LSB's proposals on ring-fencing the discharge of regulatory functions would suggest that responsibility for controlling the mechanism should rest with a regulatory arm.

4.120. Using this basis, the SRA suggested that it should be a regulatory arm, rather than an approved regulator, that submits the application to the LSB. It should also be the regulatory arm that has lead responsibility for allocating the burden of the fee (for example between different types of individual lawyers; and between individuals and entities). And it would be regulatory arms which would then control the collection of the fee, providing whatever funds were agreed to the approved regulator where such funds were raised for non-regulatory permitted purposes.

The total cost of regulation (including the funding of permitted purposes) has to be collected from the regulated community as fairly as possible. Allocating the cost can involve a number of difficult policy issues and choices. We believe that the intention of the Act is that such decisions should not be made by a representative-controlled approved regulator, but as part of the regulatory arrangements, subject to the approval of the LSB. The consultation paper does not deal explicitly with this point, and it would be helpful for the LSB to confirm that this reflects its understanding of the Act.

Solicitors Regulation Authority

4.121. In its submission, the Law Society suggested that there is no reason why the practising fee function should be delegated. The Society suggested that it "would plainly be inappropriate for responsibility for [managing the process] to rest with the regulatory arm when fees will include the sums required for non regulatory purposes under section 51(4) of the Act". Clearly, that argument has a flip-side too.

4.122. The Law Society also suggested that any delegation of function here would do nothing to secure proper independence, because the LSB has sufficient powers elsewhere. Of course, the LSB is likely to make wider requirements and have the ability to enforce the rules it eventually makes. One of the rules the LSB has proposed thus far is that responsibility for regulatory arrangements should be delegated to regulatory arms. The case put by the SRA seems to be backed by compelling logic.

4.123. The LSB notes, however, the wider concerns expressed by respondents generally about rules becoming too prescriptive. Such concerns would apply especially in sensitive areas like financing and resourcing. Policy rationale has been set out here and elsewhere and the clear view of the LSB is that regulatory arrangements should be controlled by regulatory arms, where approved regulators have dual functions. It is for approved regulators to determine their arrangements, subject to compliance with LSB rules. Where any approved regulator seeks to certify compliance with the rules eventually made, it will have to demonstrate that compliance in all respects.

The LSB concludes that:

- as part of their applications, approved regulators should disclose revenue raised through mechanisms other than practising fees where that revenue is to be applied to permitted purposes. That information should be disclosed in such a way that ensures those paying the fees can understand how money they pay is to be applied; and
- as control of mandatory regulatory arrangements should be delegated to regulatory arms, approved regulators must demonstrate that all such arrangements (including in relation to practising fees) have been delegated appropriately.

Question 17 – Draft rules

4.124. Chapter 5 of the consultation paper set out a set of draft rules, which the LSB intended to be the basis upon which its eventual rules under sections 30 and 51 would be made. Question 17 sought views on those draft rules.

4.125. The vast majority of respondents (over two-thirds) expressed no view on the specific drafting of the rules, instead relying on the points of detail raised throughout their submissions on key aspects of proposed policy. A small number of respondents expressed strong support for the proposed set of rules.

You have “hit the nail on the head” with the proposed rules.

Mark Frost, Solicitor-Advocate

4.126. Eight respondents made specific suggestions as to how the draft rules should be modified. Those responses are summarised in the table below.

Respondent	Drafting suggestions
BSB	<p>BSB considers the draft rules “strike the right balance” subject to:</p> <ul style="list-style-type: none"> • (Rule 2) it is unnecessary for the LSB to attempt to define “reasonably practicable”. Analysis of the Act explains clearly what the phrase means and that it does nothing to provide an obstacle to fulsome delegation of functions; • (Rule 3) the rules should be extended to cover provisions about regulatory appointments, appraisals, reappointments and dismissals; a definition of non-lawyer; and additional guidance as to what the draft rule 3(3)(b) (which is important and necessary) means in practice; and • (Rule 5) there must be a requirement for approved regulators to establish a procedure for resolving any disputes that arise as to the provision of resources. There must also be express protection for the regulatory arm’s access to resources.
City of Westminster and Holborn Law Society	<p>The proposed rules are “a very worthy first attempt” but they need tightening. In particular:</p> <ul style="list-style-type: none"> • rule 3(3)(b) is much too sweeping; and • requirements biting on approved regulators in relation to their own arrangements are in many respects too vague and/or ambiguous.
ILEX/IPS	<ul style="list-style-type: none"> • (Rule 2) It is not necessary or desirable to define “reasonably practicable”. • (Rule 3) This rule is too detailed. Sub-clauses 1 and 2 should remain, with the balance of the provisions being transferred to guidance. • (Rule 4) Sub-clause 1 is appropriate, but sub-clause 2 is more appropriate to be issued as guidance. • (Rule 5) Sub-clause 1 is appropriate but everything that follows seeks to limit approved regulators’ flexibility too much. • (Rule 7) This rule is unnecessary.
Law Society	<p>The proposed rules seem unnecessarily detailed and in many respects out of step with the position adopted by the LSB in its narrative. In particular:</p> <ul style="list-style-type: none"> • rules should concentrate on high-level principles rather than being too prescriptive; and • the scope of the regulatory arm’s responsibility should not (as per draft rule 3(5)) be determined by itself. It is the approved regulator, regulated by the LSB and, ultimately, the courts, who should take such decisions.
LCS	<p>The rules should define what they mean by “non-legally qualified members”. It is suggested that the LSB adopt the position of the Legal Services Act when defining non-lawyers (see LSA Schedule 15, para 2(3)).</p>
LSC	<p>Whilst supporting the ‘whistle-blower’ provision suggested in draft rule 6, it is suggested that a similar mechanism should be available for external bodies to report concerns.</p>
LSPi	<p>The following suggestions were made in relation to Part A rules:</p> <ul style="list-style-type: none"> • in Rule 3(1): replace “they (the arrangements)” with “those arrangements”; • in Rule 3(2): replace “person(s)” with “person” (or “person or

	<p>persons”);</p> <ul style="list-style-type: none"> • in Rule 3(7): to be consistent with Rule 3(6)(a), replace “representative oversight body” in both places with “independent oversight body”; • in Rule 3(7), sub-rule (c) seems to us to be insufficiently precise in its meaning and import, since it is not clear what the resolution in question must relate to; • in Rule 3(7), sub-rule (d) appears to be circular, in the sense that the Board can intervene when it feels it is appropriate to direct itself to do so, but does not specify any “matters”. It might be reasonable for the Board to reserve to itself a general power to intervene: in such a case, this power could (and in our view should) be differently expressed; • in Rule 4(1): replace “person(s) or organisation(s)” with “person or organisation”; • in Rule 5(2)(b): before “authority” insert “independent regulatory”; and • in Rule 7(2): replace “entrenched by” with “set out in sections 1(1) and 28(3) of”. <p>The following were suggested in relation to Part B rules:</p> <ul style="list-style-type: none"> • in Rule 2(b): replace “practise fees” with “practising fees”; and • in Rule 3(2)(g): replace “working to increase” with “the increase of”.
SRA	<ul style="list-style-type: none"> • (Rule 3) Should be expanded to encompass the appointment and tenure of members of the independent oversight body, so as to ensure genuine separation. • (Rule 3) Strong support expressed for rule 3(5).

The LSB concludes that:

- in keeping with the tenor of consultation comments about principles, rules and guidance, the LSB will restructure its proposed rules in the manner consistent with other sets of draft rules recently published for consultation;
- the restructured rules should be drafted so as to meet the policy conclusions set out in this paper.

Question 18 – Draft impact assessment

4.127. Annex C of the Consultation paper set out a draft impact assessment. The assessment covered the purpose and intended effect of the proposals being made in the body of the consultation paper; the policy objectives underlying the proposals; and an analysis of the impact the LSB envisaged that the proposals would have. In particular, analysis focused on the impact on approved regulators (both larger and smaller bodies) and the impact on authorised persons. Equality and diversity issues were considered in the analysis.

4.128. Question 18 of the consultation paper asked for respondents' comments on the draft impact assessment. The assessment itself said that the LSB was "keen to find evidence of indicative actual costs of compliance, and of other impacts, to enable a robust analysis" of the proposals. The overwhelming majority of respondents chose not to respond to question 18. A small number did make comments, although none provided any indicative costs predicted to arise in respect of compliance.

4.129. Specific comments made in respect of the draft impact assessment included:

- the proposed objectives summarised in bullet form at paragraph 14 of the impact assessment should include explicit reference to the need to avoid conflict of interest between representational work and regulatory work within dual-function approved regulators;
- when impact is assessed, the LSB should look beyond the regulated community. For example, students training to become lawyers could be impacted by proposals and so explicit focus on that group should be included; and
- the key risk that, if costs rise disproportionately or unreasonably, lawyers might walk away from regulation if they do not need authorisation from an approved regulator to practise in non-reserved areas, must drive the LSB attitude to proportionality.

[We] welcome that LSB has developed rules on the basis that consumers' interests are at the heart of these.

Office of Fair Trading

4.130. Insofar as indicative costs are concerned, as noted at paragraph 3.25 and footnote 11, the Law Society did provide estimates for the costs it would face if a shared services model were no longer permitted.

The LSB concludes that:

- proportionality remains a key concern for approved regulators, large and small. While principles cannot be compromised, the way in which they are met must be as flexible as possible; and
- a finalised impact assessment will be published alongside the rules made by the LSB before the end of the year.

Question 19 – Other issues

- 4.131. At the end of the consultation paper, Question 19 afforded the opportunity for respondents to raise any issues not covered previously. Of the 11 respondents choosing to answer the question, most simply reiterated key points from the earlier submissions – both positive and negative.
- 4.132. Insofar as concerns continued to be expressed, one respondent felt that the LSB has so missed the point that he wondered whether it has “actually taken any legal advice on [its] paper”. In answer: yes, it had. The Board also used a mass of consumer evidence to develop a scheme that was designed to put consumers at the heart of the regulatory agenda.
- 4.133. In terms of process, some respondents welcomed the approach taken to engaging stakeholders throughout the process. Indeed, the stakeholder event held in July received much positive feedback from those that attended.
- 4.134. However, a small number of respondents expressed concern at the approach taken. For example, the Tunbridge Wells, Tonbridge and District Law Society considered “the consultation period to have been inadequate for the considerable amount of time needed for members of the profession to fully understand the impact of the proposals”. Legislation requires the LSB to make rules before 31 December 2009. Having engaged with key professional bodies and consumer groups since October 2008 and engaging on the basis of a plan designed to include two formal periods of consultation (the first of which lasted over 13 weeks), the LSB is unclear how it could have extended the timetable. However, it extends an open invitation to any organisation or individual who wants to discuss issues raised in the supplementary consultation paper, or this response document.
- 4.135. Finally, some respondents noted the LSB’s drive to make approved regulators more transparent and suggested that the LSB itself, therefore, needed to lead the way in that respect. This, it was suggested, is an opportunity for the LSB to show leadership across the sector. The LSB agrees. The work it is doing during its implementation project (which runs through 2009) will define exactly how the LSB expects to meet required transparency standards. It will expect approved regulators to look at their own processes to ensure best practise is observed or exceeded also.

My final comment is that the LSB itself will set the tone in terms of transparency, particularly in relation to openness over how it spends money allocated to it, for what purpose and its expenditure ceiling. By maintaining for itself the highest standards of transparency, the LSB is more likely as a result to encourage the approved regulators to be fully accountable.

Legal Services Ombudsman and Complaints Commissioner

The LSB concludes that:

- in respect of the LSB, it is important to maximise its own transparency while seeking the same from approved regulators. To that end, plans are already in place to see (among other things) the implementation of a publication scheme designed to comply with the Freedom of Information Act when the Board takes on the full range of its powers early in 2010; and
- in respect of the continuing regulatory independence consultation, further engagement will be necessary with stakeholders across the board while we test proposals in the next stage of consultation.

5. Conclusions and next steps

- 5.1. At paragraph 1.14 of the consultation paper, the LSB set out an indicative timetable for the remainder of its planned engagement strategy. Those proposals included a second consultation period to focus on rules developed in light of responses to the first consultation.
- 5.2. Alongside this post-consultation report, the LSB has published its second consultation. Representations on the proposed rules set out in that document are invited by no later than **noon on Friday 30 October 2009**.
- 5.3. It is in that paper that the LSB puts forward its proposals for rules to be made under sections 30 and 51 of the Legal Services Act. The detail of that work need not be repeated here. However, building on the analysis of consultation responses – and on the reaction to policy ideas tested at the July stakeholder event²² – the LSB takes the opportunity afforded by this chapter to set out the high-level basis on which it proposes to proceed.

Scope of rules

- 5.4. Consultation responses displayed, among other things, a lack of consensus on the precise ambit of the LSB's discretion in making rules, in particular under section 30 of the Act. A significant number of the legally-qualified respondents suggested that the LSB had overstepped the ambit of its discretion in proposing to make the rules set out in the consultation paper.
- 5.5. To that end, it would be useful for the LSB to set out, after having considered all responses, what it considers the scope of its powers to be. Some might want the LSB to interpret this scope more narrowly or in another way. If it can be shown that the following understanding is flawed, then the LSB may have to reconsider some of its proposals. If, on the other hand, no legal flaw can be found, then it must follow that the basis upon which the LSB proposals are now built is sound.
- 5.6. In summary, the LSB considers that:
 - in making/applying the IGRs the LSB must act in a way which (1) is compatible with the regulatory objectives²³, (2) is considered by the LSB to be most appropriate for meeting those objectives²⁴, (3) has regard to the principles of better regulation²⁵ and (4) has regard to the principle that its principal role is one of oversight²⁶;

²² Details of the stakeholder event, including the paper circulated to invitees in advance and a note of the event are available on the LSB website at http://www.legalservicesboard.org.uk/what_we_do/consultations/closed/submissions_regulatory.htm

²³ LSA07, section 3(2)(a).

²⁴ LSA07, section 3(2)(b).

²⁵ LSA07, section 3(3)(a) and (b).

²⁶ For example, see LSA07, section 49(3).

- the public interest is served by ensuring, insofar as is reasonable, confidence (including of consumers and lawyers) in the regulatory arrangements applicable to lawyers;
- the purpose²⁷ of the IGRs is to ensure that the exercise of an approved regulator's regulatory functions is not prejudiced by its representative functions and that decisions relating to the exercise of an approved regulator's regulatory functions are – so far as reasonably practicable – taken independently from decisions relating to representative functions;
- the objective behind the IGRs is to ensure that they achieve their purpose and are perceived (by *reasonable* stakeholders) to achieve that purpose; and
- the requirement to make IGRs gives the LSB discretion to determine the necessary detail. That discretion must be exercised reasonably and in line with the above, including in relation to proportionality.

Principles underpinning the rules

- 5.7. Drawing on the above, the LSB considers that it should exercise its discretion so as to ensure in particular that people with representative functions should not exert undue influence or control over the discharge of regulatory functions²⁸ – and prevent the appearance or perception that there is any such undue influence/control.
- 5.8. Accordingly, we will expect approved regulators to delegate responsibility for performing all their regulatory functions to a body without any representative function(s) or member(s) and which is not unduly influenced by any person(s) exercising such functions. In particular:
- **appointments, appraisals, reappointments and discipline** – the appointments etc process for regulatory board members must produce a board that is demonstrably free of representative control, and of undue influence from any body, sector or constituency that could reasonably be construed as representative of the regulated community (or any part(s) of it);
 - **strategy and resources** – a regulatory board must have the freedom to define a strategy to meet its delegated responsibilities. This should include access to resources reasonably required to meet the strategy it has adopted, effective power of control over those resources and the freedom to govern all its internal processes and procedures – including communications; and

²⁷ LSA07, section 30(1)(a) and (b).

²⁸ 'Regulatory' and 'representative' functions are defined in s27 of the LSA07. Also see section 21(1).

- **residual oversight** – while it is imperative that approved regulators retain an oversight role in relation to performance of delegated regulatory functions, such oversight must not unduly influence – nor be seen to unduly influence – persons exercising those delegated functions. Oversight must also, at all times, remain proportionate.

Timetable

- 5.9. Having now developed and refined proposals, the LSB has launched its second formal consultation on the rules it needs to make. In accordance with section 205 (3) of the Legal Services Act, representations will be invited on the substance of those proposals. Because consultation – both formal and informal – has been running since before the start of 2009; and because formal rules need to be made by no later than 31 December 2009, the LSB considers that it is neither necessary nor desirable to hold another three-month consultation.
- 5.10. Accordingly, representations are invited by no later than 30 October. Submissions will be analysed throughout November and the Legal Services Board will make rules, having had regard to any representations made, in December.

Annex A – List of respondents

Submissions lodged by the following respondents are available online at:

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

Allan Murray-Jones

Bar Association for Commerce, Finance and Industry

Bar Standards Board

Bar Standards Board's Consumer Panel

Berks, Bucks and Oxfordshire Incorporated Law Society

Chartered Institute of Patent Attorneys

CHRE

City of Westminster and Holborn Law Society

Consumer Focus

Council for Licensed Conveyancers

Crown Prosecution Service

David Merkel (Lawyers with Disabilities Section, the Law Society)

Devon and Somerset Law Society

Faculty Office of the Archbishop of Canterbury

General Council of the Bar

Ian Lithman

IBB Solicitors

Institute of Chartered Accountants in England and Wales

Institute of Legal Executives and ILEX Professional Services

Institute of Trade Mark Attorneys

IPReg (Intellectual Property Regulation Board)

Irwin Mitchell LLP

Jeffrey Forrest

John Penley OBE TD (President of Gloucestershire and Wiltshire Law Society)

Law Society of England & Wales

Legal Complaints Service

Legal Services Commission

Legal Services Ombudsman and Complaints Commissioner (taken as corporate response on behalf of both offices)

Legal Services Policy Institute

Lincolnshire Law Society

Mark Frost

Norman Starritt and Patrick Russell

Office of Fair Trading

Peter Adams

Solicitors in Local Government

Solicitors Regulation Authority

Sue Nelson

Tunbridge Wells, Tonbridge and District Law Society

Which?

Annex B – List of organisations which met the LSB

Organisation	Date of meeting
Bar Standards Board	8 May 2009
Bar Standards Board Consumer Panel	22 May 2009
Council for Licensed Conveyancers	15 May 2009
Institute of Legal Executives and ILEX Professional Services	7 May 2009
Intellectual Property Regulation Board	5 May 2009
Institute of Trade Mark Attorneys	26 May 2009
Law Society of England and Wales	5 May 2009
Ministry of Justice	28 April 2009
Monitor (the regulator of NHS Foundation Trusts)	11 May 2009
Solicitors Regulation Authority	13 May 2009
Which?	22 May 2009

List of organisations represented at the LSB stakeholder event on 29 July 2009

Organisation
Bar Council
Bar Standards Board
Bar Standards Board Consumer Panel (also representing LSB Consumer Panel)
Chartered Institute of Patent Attorneys
Citizens Advice
Consumer Focus
Council for Licensed Conveyancers
Institute of Legal Executives
Institute of Trade Mark Attorneys
Intellectual Property Regulation Board
Law Society of England and Wales
Master of the Faculties, the Faculty Office
Ministry of Justice
Solicitors Regulation Authority
Which?