

Internal Governance Rules (IGR) Consultation stakeholder workshops: December 2018

The Legal Services Board (LSB) held three workshops to provide clarification on the published document and its annexes in order to assist attendees in responding to the consultation. Sessions were held on:

4 December 2018	12.00-13.00	Open session
11 December 2018	12.30-13.30	Open session
13 December 2018	11.30-12.30	ACCA and ICAEW only

This is a record of the points made and, where appropriate, the LSB response:

General

1. There may be a need to change rules as a result of the proposed IGR. Will the LSB issue a 'blanket' exemption direction to cover these changes as it did in 2010 when the IGR were first introduced?

LSB response: We are considering how any rule changes will be dealt with.

2. Why did the LSB decide to remove the applicable approved regulator (AAR) definitions; surprised that it was difficult to understand – who found it difficult?

LSB response: We have had queries from a number of parties and consultation respondents seeking clarification on its meaning. The reasons why the LSB decided to remove the AAR definition is set out in the LSB's July 2018 [IGR decision document](#).¹

3. The proposed IGR and guidance are prescriptive rules and not the outcomes-based approach that was promised.

LSB response: We consider that we have delivered principled and outcome-focused rules but (as we said we would in our July 2018 [decision document](#))² we have more specific rules to address the areas where there have been flashpoints and the LSB has had to get involved in resolving disagreements/undertake investigations.

4. To what extent has the Ministry of Justice (MoJ) been involved?

LSB response: The LSB is an independent regulator and the MoJ is a stakeholder like many others. It is not involved in our work on the IGR. The MoJ is aware of the LSB work. As government departments do with many other arms-length bodies, the MoJ carried out a tailored review of the LSB, one of the recommendations from which was that the LSB should work within the Legal services Act 2007 (the Act) to maximise independence.

5. The LSB appears to ignore the other regulatory objectives in the Act in drafting the IGR.

¹ Our decision to remove the AAR definition is set out at paragraphs 32-34 on pages 15-17.

² Page 36 of our decision document

- The proposed IGR may make it difficult for some approved regulators (ARs) to remain as regulators and may force accountancy firms (particularly small- or mid-sized firms that do not want to be dual-regulated) out of carrying out probate activities. This would have a detrimental effect on competition.
- The LSB does not take account of the fact that some ARs are regulating other things. The rules seem unfair to regulators who fall under other regulatory frameworks. The IGR don't recognise the regulatory track record.
- Why is the LSB introducing new rules for all regulators when only some have issues? There are measures in place to uphold high regulatory standards.

LSB response: The LSB regulates legal services and the purpose of the IGR is to meet our obligations under s.30 of the Act which is to address the separation of regulatory and representative functions for legal services. The public interest and consumer risks in relation to legal services are not necessarily the same as for other professional services. The LSB has considered (as it is obliged to do) all regulatory objectives as referenced through s.28.

The Act is not perfect and we consider that in our drafting we have found a way to deal with the different practices of the approved regulators. The rules deal with mischief caused by the representative function prejudicing the regulatory function. We will work with ARs to ensure compliance and we will consider applications for waivers under the saving provisions which must be supported by evidence.

We encourage regulators to explain in their consultation responses how the rules will be difficult to follow. We have talked to other regulators, such as the Financial Reporting Council (FRC), who are interested in our approach to separation because they face similar challenges. There is a trend in the regulation of many professional groups towards greater separation of regulation and representation to address the public perception of issues where there regulation is not seen to be independent. The Kingman Review into the FRC considers issues of independence in the auditing profession.

6. Why is the LSB forcing all regulators to comply with these IGR on the basis of two investigation outcomes? What other evidence of harm is there? Where is the evidence that independence is an issue in the accountancy sector?

LSB response: The LSB presented its evidence base in previous consultations which extends beyond the 2 investigations.³ We consider that the proposed IGR are reasonable in light of this evidence and experience. We will act proportionately following the mechanisms in the rules and guidance and Rule 16: Saving provisions is available to regulators.

Overarching duty

7. The AR remains legally liable for the discharge of the regulatory functions under the Legal Services Act. How can enforcement action be taken by the LSB against the AR (for example for any failure to perform those regulatory functions) when the AR has been required by the IGR to delegate those functions to a separate regulatory body?

LSB response: The LSB would take action directly against the regulatory body if required. We can do that through the delegation agreement, as the regulatory body is

³ Our [2017 November IGR consultation](#) pages 10-14 cover this evidence basis

given its regulatory functions by delegation from the AR. By delegation, the regulatory body assumes responsibility for discharging regulatory functions. It therefore is the “AR” in relation to that role. (The LSB currently assesses rule change applications that come directly from the regulatory body on this basis).

8. Why have you chosen certain language, in particular you have used the word influence instead of prejudice?

LSB response: We have carefully considered the words that we used and believe them to be the right ones but may look at this again in light of consultation responses

9. The overarching duty isn't new

LSB response: There is a change in the language in that regulatory functions are not influenced by any representative functions or interests. In addition there is a new requirement to periodically review the arrangements for separation and maintenance of independence of regulatory functions.

10. The LSB is proposing new rules, in particular rules 1 and 4, which go further than the Act. The use of the word influence would restrict legitimate representative activity and leave the AR in a weaker position than other stakeholders in terms of expressing views to the regulatory body

LSB response: We are prohibited from interfering in representative functions under the Act. We will consider the point raised about the position of the AR in comparison with other stakeholders. These rules regulate the interaction between the AR and its regulatory body.

11. The wording in relation to budgets seems to imply that the regulatory body doesn't have to consult on its budget which is not consistent with other LSB rules. LSB needs to clarify the obligation to consult on budgets given the guidance on Practising Certificate Fee (PCF) proposals.

LSB response: The requirements relating to the submission of the PCF application to the LSB are contained in separate LSB rules. We decided to keep the PCF rules separate and will be considering reviewing them. Currently the PCF rules require consultation at a minimum every 3 years or when there is a change in the PCF or the basis for calculating the PCF changes.

12. There is an issue on the terminology used – in some rules you use influence and in others prejudice. Has the LSB considered the use of language in light of the parliamentary discussions when the Act was debated? The LSB should take account of the will of Parliament.

LSB response: We have followed the terminology from the Act, passed by Parliament. We have sought to remove confusion by removing ‘undue influence’ and we will follow the accepted ‘plain English’ meaning of the terms we use. We have been careful with our drafting not to extend beyond our vires. However, as noted above we may consider the use of the terms influence and prejudice as part of our final review.

Separation and Assurance

13. Will the rules force legal separation?

LSB response: We are unable to require full legal separation. We outlined the legal context in Annex A of our November 2017 IGR consultation document and we also explain the legal context in section 1 of the guidance to the IGR. However, nothing in these rules prevents an AR creating a regulatory body that has its own legal identity if that is what the AR wishes to do.

14. A general concern was expressed that the proposed new IGR require the AR to assure itself about regulation but also limit the ability of the AR to require its regulatory body to undertake certain actions.

LSB response: Matters can be referred to the LSB for clarification under proposed rule 14. The LSB will seek to publish any response it provides so that there is a shared library of knowledge about what is required.

15. If the LSB had wanted to maximise separation, rather than drafting this set of rules, it should have insisted on separate income streams as some regulators already have.

LSB response: As set out in Annex A of our November 2017 consultation document, we are unable to specify legal separation of legal services regulators from the ARs from whom their regulatory functions have been delegated, for example, requiring the AR to set up a subsidiary with a separate legal identity to carry out its regulatory functions. An AR who regards itself as having independent regulatory functions should be able to be demonstrated that these arrangements are in compliance with current and future IGR.

16. Can the LSB explain how the proposed IGR will work, given the current arrangements in place within particular ARs?

LSB response: The LSB team are happy to discuss an AR's present arrangements to help inform that AR's consultation response. For example, in relation to the complexities associated with accountancy regulators. However, we cannot give certainty on what waivers (if any) would/could be granted as this would be a matter for the LSB on a case by case basis.

Regulatory Autonomy

17. Are there any roles that should never be dual roles where a role reports independently of the representative functions but provides services to both the regulator and representative function?

LSB response: It will be important to consider the details of the actual role, for example HR and IT directors. ARs and regulatory bodies can ask the LSB for clarification or advice. If the regulatory body and AR were in agreement that would be strong supporting evidence for a waiver/exemption application to share services on the basis that the conditions in proposed rule 11 were met.

18. There was concern raised about the terms used in the proposed rules such as 'materiality' in rule 5 on the prohibition on dual roles and how this interacted with shared services. For example the role of Personal Assistant to a decision maker would be considered material, and the PA could not therefore have a dual role, even if this was part of shared services.

LSB response: It will be important to consider the details of the actual role, for example HR and IT directors. ARs and regulatory bodies can ask the LSB for

clarification or advice. The LSB would put considerable weight on the AR and regulatory body agreeing to share services on the basis that the conditions in proposed rule 11 were met, both in deciding whether shared services were permissible and in looking at a request for a waiver/exemption in relation to the prohibition on dual roles.

19. A concern was expressed that executives in ARs would be unable to work on regulatory body delegation or assurance arrangements without breaching the prohibition on dual roles

LSB response: The AR's delegation and assurance work is specifically excluded from the scope of the new IGR via the exclusions in the definitions of 'regulatory arrangements' and 'regulatory functions' used in the new IGR, so the prohibition on dual roles would not apply.

20. How should dual roles be considered as the LSB is not suggesting imposing a structure on ARs? In some cases it is beneficial to have a cross-over of regulatory roles with representative role to allow concerns to be raised and to avoid conflict situations.

LSB response: The Act states that there must be no prejudice of regulatory functions by representative functions and this rule is consistent with that. We think attempting to combine dual roles within a single individual gives rise to an unreasonably high risk of conflict of interest.

Conduct and responsibility

21. How can the AR be assured if the board of the regulatory body is free to act and the AR is not able to intervene? What if the board appoints themselves in perpetuity and awards themselves unreasonable remuneration packages?

LSB response: The requirements relating to the submission of the PCF application to the LSB are contained in separate LSB rules. We will always take a proportionate and appropriate approach and will undertake our normal scrutiny of any increases in the PCF. We can and do agree increases in PCF where these are properly justified, and where the PCF application includes the additional information required under our revised PCF rules issued in 2016. We publish our assessments of PCF applications.

Governance

22. The PCF for 2019 is already set and the 2020 PCF budget will be finalised before the final IGRs are published; meaning a strict six month full implementation would be problematic. Is the six months implementation timescale the deadline to fully implement the new IGR or is it to have an Action Plan in place and to have started implementing?

LSB response: Our current plan is that the finalised new IGR would come into force in April 2019 and during the six month transition period following that date, we would expect that ARs and regulatory bodies come into compliance with the new IGR. If at the end of that period there are areas of non-compliance applications can be made to the LSB for waivers. We expect that there are a number of elements of the proposed IGR that could be incorporated into the existing work plan without large budgetary/PCF implications. If a waiver was sought for non-compliance we would want to see commitments/evidence as to how the non-compliance was to be resolved or managed.

Budget and resources

23. Will the LSB's IGR and shared services compliance assessment process be regulator/AR self-certification? If not, and the assessment process is more involved, it would be helpful to understand what the LSB is envisioning.

LSB response: In our consultation we said that assurance of ongoing compliance with the IGR (i.e. after the initial transition period) will be carried out as part of the LSB's regulatory performance framework. For the avoidance of doubt, the LSB has no intention of seeking assurance from ARs on the full regulatory performance framework, only on compliance with the IGR (since the other elements of regulatory performance are matters for the regulatory body, not the AR).

24. If the AR and regulatory body were in agreement and came to the LSB with a request for a waiver are there any circumstances in which the LSB wouldn't agree to it?

LSB response: Agreement between the regulatory body and AR would be strong supporting evidence for a waiver/exemption application. We expect that the regulatory bodies will be strong champions of their own independence. However, we will take our own view, taking into account the case made for the waiver, the rules, the guidance and the regulatory objectives.

25. Would a Director of Shared Services meet the material requirements under rule 5 and therefore be prohibited?

LSB response: Issues will be considered on a case-by-case basis when determining whether a role can be shared or not. A key element to be considered will be whether the role can have influence over regulatory decisions

26. Could an exemption or waiver be permanent?

LSB response: There is no hard and fast rule for how long any waiver might be. The Overarching duty requires that you keep the arrangements made under the IGR under review.

27. Have you got any specific idea of how you will measure the 'marked benefit' or 'material cost saving overall' (language used in Guidance on Rule 11) with regards to shared services?

LSB response: We won't be using a specific definition as the scale and materiality of cost savings/benefits will vary amongst different AR/regulatory body pairs. What we will be looking for is that the arrangements are not just borderline and that assessment will depend on the size and impact of the arrangements. What is appropriate for one AR/regulatory body pair may not be appropriate in other circumstances.

28. How will the PCF budget be assessed if the IGR cause an increase in budget requirements due to the arrangements around shared services changing? Given that the IGR require reasonable resources to be provided, what if more resources are required, in particular to build reserves, as a result of this process? There was a concern that the PCF and IGR rules have an inherent tie and will the LSB clarify that interrelationship?

LSB response: The requirements relating to the submission of the PCF application to the LSB are contained in separate LSB rules.⁴ We will always take a proportionate and appropriate approach and will undertake our normal scrutiny of any increases in the PCF. We can and do agree to increases in PCF where these are properly justified. We publish our assessments of PCF applications.

29. Would it be helpful going forward if there is more separation that the regulatory body has its own reserves?

LSB response: Each body will have different requirements and arrangements. We are happy to talk with you regarding the specific concerns you have during the transition period.

Communication and Candour with LSB

30. It is not clear whether the LSB will make a decision on any dispute that is brought to it under rule 14.

LSB Response: Rule 14 as currently written does not oblige the LSB to respond. This is because attempts to resolve the issue without involving the LSB may not have taken place or not have been sufficient, or because, in light of the nature of the dispute, the LSB may want to take action other than through making a response under rule 14 (e.g. more formal enforcement action).

31. How frequently will the LSB seek to assure itself of compliance with the IGR?

LSB response: There will be ongoing proactive LSB monitoring which will be carried out periodically to give us assurance of compliance. In addition to this, both the AR and regulatory body will be under a continuous “duty of candour” to report to us at any time any non-compliance that can’t be resolved. We invite comments in your consultation response on how regular you believe the proactive monitoring by the LSB will need to be.

Guidance and Saving provisions

32. The LSB could be clearer about when obligations apply to an AR, a regulatory body or both. The guidance document should be understandable to all of those that use it, for example those that might fall under the dual role obligations. Making the rules clear to a lay person is a good guide to making them understandable

LSB response: The draft IGR Guidance is a little more technical than our previous documents although we have tried to ensure that it is useful to assist with compliance with the Rules. If you consider that we need to provide more clarity in specific areas please detail this in your consultation response.

33. How will the principle of s.16 – saving provisions - apply and how will ARs have certainty that waivers will be issued? Can the LSB consider the wording of the saving provision so that it takes into account indicators of the independence of an organisation separate from its arrangements for legal services?

⁴ LSB PCF [rules](#) and [guidance](#)

LSB response: We must consider each application under the saving provisions on a case-by-case basis and on the evidence provided and must consider these in the context of what the Act allows.

34. Can the guidance be shortened to what the ARs and regulatory bodies must do and not what the LSB will do?

LSB response: We will consider the draft guidance as part of our final review.

Links to documents referred to during discussion:

[LSB Vision for Legislative reform](#) (PDF)