



The Law Society

**Response of the Law Society of England and Wales
to the Legal Services Board consultation on
Reviewing the Internal Governance Rules**

February 2018



PREFACE

1 The Law Society of England and Wales ("The Society") is the professional body for the solicitors' profession in England and Wales, representing over 170,000 registered legal practitioners. The Society represents the profession to parliament, government and regulatory bodies, and has a public interest role.

2 Rather than responding to each individual consultation question, this response provides the Society's broader views on the extent to which we believe the LSB's Internal Governance Rules ("IGRs") may be clarified and improved.

3 Under Schedule 4 of the Legal Services Act ("the Act"), the Society is an approved regulator. Different approved regulators have different arrangements, and the scope of the delegation varies. In the case of the Society, the scope of the delegation goes beyond the minimum requirements in section 21 of the Act.

EXECUTIVE SUMMARY

4 This review presents an opportunity for the LSB to clarify the requirements and implementation of the IGRs, and to ensure that there is consistency of approach by the LSB in respect of all the approved regulators. Clarification of some parts of the IGRs would help approved regulators strike the appropriate balance between regulatory independence and regulatory assurance. We believe this can be successfully achieved within the current legal framework.

5 Since the introduction of the Act, the Society has committed to meeting the requirements of an approved regulator. It would assist both the approved regulators and the frontline regulators to have greater clarity regarding the expectations of the LSB. Clear, targeted IGRs would support both to discharge their roles effectively, and this in turn will improve and underpin public confidence in legal regulation. Greater clarity should support the regulatory objectives of "protecting and promoting the public interest" and "encouraging an independent, strong, diverse and effective legal profession", which are particularly important in this context.

6 We are therefore keen to work with the LSB to ensure that any changes to the IGRs:

- assist both approved regulators and frontline regulators in carrying out their respective duties efficiently and effectively, and with a minimal risk of ambiguity or potential disagreement;
- increase the public and the regulated communities' understanding of the respective roles and responsibilities of approved regulators and frontline regulators.

7 We note that the LSB wrote to stakeholders on 12 January 2018, noting that this consultation and review is separate from the ongoing LSB investigation of governance arrangements between the Law Society and the SRA, but the LSB will take account of evidence from that investigation once it has concluded. However, the Society also notes that the consultation closes on 9 February 2018, and that the LSB does not expect to report on the investigation before then. In the Society's view, this timing is unfortunate, in light of the subject of the LSB investigation and the recent changes introduced to the arrangements between the Society and the SRA. It seems to the Society that the consultation would have been more beneficial if it were able to take account of matters relevant to the LSB investigation and its report. However, we note that the LSB would be happy to receive

additional comments after its investigation report has been published. The Society may avail itself of that opportunity.

COMMENTS

The existing IGRs

8 Approved regulators are responsible under the Act for the discharge of regulatory functions.¹ The Act also requires 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 the exercise of its representative functions”.²

9 As an approved regulator, the Society is unequivocally committed to ensuring the independence of its regulatory and representative functions within the boundaries of the Act. The Society acknowledges that, although regulatory functions are carried out independently of representative functions within the Society, the public perception of that relationship is important to promote the standing and reputation of the legal profession and to retain consumer and public confidence. This is not only important from a regulatory perspective. The representative function must be able to freely represent the views of the profession and public interest.

10 Any arrangements should also be clear and workable to avoid inefficiency, increased cost and reputational risk to the approved regulator. However, the arrangements must permit the approved regulator to discharge its obligations under the Act.

11 In the case of the Society, the SRA (the frontline regulator) operates as a board within a group structure, with delegated powers. The Society has no insight into the regulatory activities of the SRA, save to the extent that they are reported, published or disclosed. Certain resources and controls – for example finance, audit, HR, procurement, IT – have historically been provided centrally, to avoid duplication of back office functions and to minimise, as far as is possible within the Act, the cost of regulation, of importance to the consumer interest.

12 In 2017, the Society and the SRA reviewed the Society's General Regulations, resulting in a series of changes to our internal governance arrangements, upon which we may comment further in due course.

13 The Society found the IGRs were of limited assistance in determining whether changes were necessary and to what extent. The IGRs reflect the same high-level principles as the Act, and require judgements to be formed about how they should be implemented, particularly in respect of proportionate regulatory oversight.

14 An example is the audit function. There is a potential tension between requirements set out in publications like the UK Corporate Governance Code and the requirements of the IGRs. Placing functions, which are designed to monitor risk, in the exclusive control of the frontline regulator is a significant decision, which implies greater risk to the group as a whole. The IGRs could explicitly address the question of how this potential tension should be resolved to meet both the independence requirements and the principles of good governance that avoid risk to the group entity.

¹ Those functions are outlined in section 21 of the Legal Services Act.

² Section 30(1)(b)

15 Another issue that could be improved in the current IGRs concerns complaints and dispute resolution. In principle, the test of undue influence outlined in the IGRs is sound.³ It would be more efficient for the parties involved if the IGRs could include a mechanism to incentivise parties to resolve potential disputes which unless addressed through dialogue, may escalate into complaints concerning undue influence. Such a mechanism could include early assistance from the LSB.

The role of approved regulator

16 In performing its role as approved regulator in relation to the reserved legal activities identified in Part 1 of Schedule 4 to the Act, the Society has an oversight responsibility in relation to the performance of regulatory functions by the SRA for three, linked, reasons.

17 Firstly, the statutory scheme provides that the Society is the approved regulator. Under the Act, the Society, as the approved regulator, is responsible for the acts and omissions of its regulatory arm, the SRA. Therefore, the Society must be permitted - and indeed is required - to establish scrutiny and monitoring arrangements by which it can hold that regulatory arm to account, without adversely affecting its decision-making, operational effectiveness and independence.

18 Secondly, the Society is answerable to the LSB for the performance of its regulatory functions⁴, and the Society must therefore be able to reliably monitor performance by the SRA.

19 Thirdly, the relevant provisions of the Act must be read and understood together with the provisions of the Solicitors Act 1974. The separation of regulatory and representative functions is achieved by delegation within the Society as the approved regulator.

20 For these reasons, the Society retains a role of oversight of the performance by the SRA of the regulatory functions. This is consistent with the Schedule to the IGRs which states in Part 4:

"Oversight and monitoring by the [Society] (which is ultimately responsible and accountable for the discharge of its regulatory functions) of persons performing its regulatory functions must not impair the independence or effectiveness of the performance of those functions".

21 Questions arise about the nature and application of this oversight.

22 For aspects of the business conducted by frontline regulators, our governance arrangements recognise that approved regulators (with representative functions) cannot apply all aspects of oversight. This would certainly apply, for example, to decision-making in relation to disciplinary proceedings. To the extent that oversight cannot be delivered by the approved regulator, owing to the requirements of the IGRs and the Act, the Society and the public look to the LSB to ensure that the regulatory objectives are not compromised and that performance is properly monitored.

23 For other specific aspects of the business conducted by frontline regulators, it is appropriate for approved regulators to apply oversight. In order to monitor statutory risks, comply with financial and audit requirements and discharge duties as designated under the

³ "pressure exercised otherwise than in due proportion to the surrounding circumstances, including the relative strength and position of the parties involved, which has or is likely to have a material effect on the discharge of a regulatory function or functions."

⁴ Section 31 of the Act

Act, the approved regulators require timely and frank disclosure from frontline regulators. Failure to achieve transparent disclosure may compromise other activities and resources of the approved regulator. It is the approved regulators that can be held accountable for breach of statutory responsibilities, e.g. GDPR. Therefore, there are areas where the approved regulator has a legitimate interest that it needs to effectively protect through its oversight role.

24 There are some areas where it is important that rigorous oversight is applied to the activities of the frontline regulator, but it is unclear from the IGRs the extent to which approved regulators can apply that oversight. For these areas, clarification is needed.

25 In light of the Society's experience, we believe that this consultation provides an opportunity to introduce:

- Refinements to the IGRs to provide more clarity about the oversight role of approved regulators and the transparency required in disclosure and reporting by frontline regulators;
- More pro-active involvement of the LSB in ensuring appropriate accountability of frontline regulators and monitoring of complaints about the performance of regulatory functions.

26 The Society is confident that the framework provided by the Act and the IGRs provide an appropriate mechanism for enabling proportionate and well-functioning oversight of regulatory functions whilst maintaining the principle of regulatory independence.

Clarity of the IGRs

27 We believe that this is a good opportunity for the LSB to explicitly clarify the meaning and practice of oversight under the IGRs, to help us and others apply the rules to better effect. An approved regulator needs to be confident about the definition of oversight, in order that it can carry out its role without the uncertainty of whether its interpretation of the IGRs will be challenged.

28 In particular, the Society suggests that the rules and guidance in Parts 3 and 4 of the Schedule to the IGRs could be more precisely and fully explained. Part 4 confirms the principle of oversight and independence, as set out in paragraph 16. It further provides for two rules applicable to this principle: arrangements in place must be transparent and proportionate; and must prohibit intervention, or the making of directions, in respect of the management or performance of regulatory functions unless with the concurrence of the LSB. However, this is open to interpretation, and the relevant guidance provided in the IGRs is of limited assistance:

"In making its arrangements, an approved regulator should balance its ultimate responsibility for the discharge of regulatory functions with its responsibilities to ensure separation of regulatory and representative functions."

29 For an approved regulator, there is an irreducible minimum level of oversight required to perform its duties and meet its obligations under the Act. The Society and its frontline regulator would benefit from clear and specific guidance on the expectations of the LSB for the proper discharge of the oversight role as approved regulator and on the scope and content of that role, particularly in relation to the assurances, reporting requirements and transparency of reporting that the Society is entitled to require from the frontline regulator. It should also be noted that certain functions are representative only; it would be helpful if the

IGRs specified what these were, so that they remain representative roles and avoid confusion.

30 There seems to be a level of subjectivity in the guidance provided under the current IGRs, and the LSB's assessment is that the IGRs are open to different interpretations by different bodies. We believe that tailoring the IGRs too closely to the needs of some bodies could adversely affect others. However, the LSB could provide more detailed guidance on the requirements of the Act to ensure that approved regulators and frontline regulators have clearer guidelines of what is needed in practice.

The role of the LSB

31 Not only do we need to be clear on our duties as an approved regulator, but we would also benefit from greater clarity of the role of the LSB in determining and implementing the IGRs. We believe that the LSB should take clear and transparent positions in respect of its regulatory oversight and its requirements in relation to the performance of regulatory duties to satisfy the regulatory objectives in section one of the Act.

32 The LSB (and the IGRs) should provide for effective oversight and scrutiny of frontline regulators to ensure compliance with the legal framework, where the principle of regulatory independence means this cannot be performed by approved regulators. It is vital that the LSB carries out this role and reports upon it regularly and publicly, alongside ensuring that frontline regulators put the fullest regulatory data and information possible into the public domain in a regular, consistent and timely manner.

33 In respect of resolving disputes relating to regulatory independence, there needs to be a proportionate approach taken by the LSB. If the IGRs contain mechanisms to encourage dialogue and cooperation between approved and frontline regulators, this should provide early warning and prevent the escalation of disputes.

34 Lastly, independence is not just important in terms of the representative and regulatory divide, although that is the prime focus of this consultation. An independent legal profession, free from Government control, is one of the key safeguards of the rule of law which instils international confidence in our legal professions. This point was noted by the Competition and Markets Authority in paragraph 5.145 of its final report, and independence from Government- in both fact and perception - remains important when considering current and future regulatory arrangements.

FOR FURTHER INFORMATION

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