ICAEW
PROFESSIONAL STANDARDS

Professional Standards Department (PSD) response to the LSB Proposed Rules for Applications to Alter Regulatory Arrangements

AUGUST 2021

ICAEW PROFESSIONAL STANDARDS
REPRESENTATION 08/2021

PROPOSED RULES FOR APPLICATIONS TO ALTER REGULATORY ARRANGEMENTS

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ICAEW Professional Standards welcomes the opportunity to respond to the Legal Services Board's discussion paper Proposed Rules For Applications To Alter Regulatory Arrangements issued 15 June 2021 a copy of which is available from this link.

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This response dated 11 August 2021 reflects the views of ICAEW as an Approved Regulator for the reserved legal service of probate. ICAEW Professional Standards is the regulatory arm of ICAEW. Over the past 30 years, ICAEW has undertaken responsibilities as a regulator under statute in the areas of audit, insolvency, investment business and most recently Legal Services. In discharging its regulatory duties it is subject to oversight by the FRC's Conduct Committee, the Insolvency Service, the Financial Conduct Authority (FCA), the Legal Services Board (LSB) and the Office for Professional Body Anti-Money Laundering (OPBAS).
Amongst ICAEW's regulatory responsibilities it is;

- the largest Recognised Supervisory Body (RSB) and Recognised Qualifying Body (RQB) for statutory audit in the UK, registering approximately 2,500 firms and 7,000 responsible individuals under the Companies Act 2006.
- the largest recognised supervisory body (RSB) for local audit in England. It has eight firms and over 90 key audit partners registered under the Local Audit and Accountability Act 2014
- the largest single insolvency regulator in the UK licensing some 800 of the UK's 1,600 insolvency practitioners as a Recognised Professional Body (RPB) under the Insolvency Act 1986.
- a Designated Professional Body (DPB) under the Financial Services and Markets Act 2000 currently licensing approximately 2,000 firms to undertake exempt regulated activities under that Act.
- a Supervisory Body recognised by HM Treasury for the purposes of the Money Laundering Regulations 2007 dealing with approximately 11,000 member firms.
- designated an Approved Regulator and Licensing Authority for the administration of oaths and probate under the Legal Services Act 2007 (the Act) currently accrediting approximately 350 firms to undertake the probate activity.

GENERAL COMMENTS ON THE PROPOSED CHANGES

1. We welcome this initiative by the Legal Services Board (LSB) to clarify the processes necessary for regulatory bodies to secure approval for changes to their regulatory arrangements under the powers set out in Part 3 Schedule 4 to the Legal Services Act 2007 (the Act). In particular, we welcome the LSB's efforts to specify clearly and transparently through the proposed rules and guidance the criteria for rule change applications and the changes being made to the exemption procedure.

2. The power granted under the Act to the LSB to approve proposed changes to approved regulators' regulatory arrangements is an important safeguard for the consumer, the regulated community and the public interest. However, we have two general concerns, and one specific comment, regarding the new rules and guidance. Our first general concern is whether the degree of prescription in the new rules is proportionate and necessary given the additional work which this will generate for front-line regulators. We raise this because the consultation does not appear to evaluate or balance any benefits which the consumer might receive from these approval processes compared to the increases which consumers will inevitably see in the cost of legal services when regulators pass through their additional costs in licence fees, and firms pass on those costs to the consumer. The consultation concedes in the impact assessment that these rules will require additional reporting by the regulatory bodies, but rather than addressing this, the consultation merely notes this as being outweighed by rather broad theoretical benefits and that this is necessary collateral damage.

3. We would suggest that there should be a degree of flexibility around how the regulatory bodies demonstrate that they have had regard to the potential impact of the changes on the regulatory objectives and, in particular, diversity considerations. Depending on the nature of the proposed changes, completion of template assessment forms may not always be appropriate or proportionate and an overly prescriptive approach will result in increased regulatory burden. It is acknowledged that the LSB indicates in the Guidance that approved regulators may adopt their own format for applications, rather than rely on pro forma template, but the content still comes through as mandatory in whatever format.

4. Our second general concern is the lack of interaction between the introduction of the revised Internal Governance Rules (IGRs) in July 2020 and the revisions to the rules and guidance. We had presumed that the natural consequence of ensuring greater independence and autonomy of regulatory boards acting in the public interest would be for the LSB Board to be able to place much greater reliance on the decision-making process which has been taken prior to an application being made. This could have been seen, perhaps, in the approval process for all changes other than 'fundamental' changes requiring higher level reviews for more minor or straightforward alterations. It is unclear to us why, in the light of the new IGRs, the LSB appears to be reluctant to rely on the judgment of the regulatory boards. We believe that this is missing an opportunity to build on the IGRs by reducing the level of review needing to be undertaken by LSB staff who will inevitably be further removed from the issues on the front line.

5. In this context we believe that the Guidance paragraphs 17 and 18 could be misinterpreted as requiring regulatory boards like the ICAEW Regulatory Board, to have to approve the applications made for approval of changes to regulatory arrangements. We consider the

primary role of a regulatory board should be to consider and evaluate whether changes should be made to the regulatory arrangements in the public interest. We consider that the contents and form of an application for approval are an operational matter and that it is unnecessary and inappropriate for the regulatory boards to be involved in reviewing the contents of applications for even relatively minor regulatory changes. We believe that the aims can be achieved through the board papers supporting the actual changes clearly addressing the statutory objectives, and then for the actual application to be available through board reference material for members of the board to review should they wish to do so.

6. Our specific comment relates to our own circumstances as a legal services regulator, in being authorised to regulate a large number of regulated services. While we have separate regulatory committees to review quality assurance reports and to make decisions on whether licences should be granted or removed, we operate one disciplinary scheme for all of our members irrespective of the nature of the work being carried out. This means that any changes to our disciplinary scheme will inevitably engage the attention and interest of other oversight regulators including the Financial Reporting Council (FRC), the Insolvency Service (IS), the Financial Conduct Authority (FCA) and the Office for the supervision of the Professional Body AML Supervisors (OPBAS). Furthermore, we could also be the subject of a recommendation or requirement by any of those oversight regulators to change our regulatory arrangements. Indeed, in the current BEIS white paper, *Restoring Trust in Audit and Corporate Governance*, there is a proposal that the Audit Reporting and Governance Authority (ARGA), the replacement for the FRC, will be provided with a statutory backstop power to force the accountancy professional bodies to make changes which can include changes to regulatory arrangements.

7. While Section 54 mentions the need for regulators to avoid clashes with regulatory arrangements of other approved regulators and any regulatory provision made by external regulatory bodies, this does not address the difficulty for regulators like ICAEW if:

    a. The LSB and another of ICAEW's oversight regulators take a contrary view on what is in the public interest / in the interest of consumers; or

    b. ICAEW is obliged to make a change to its regulatory arrangements to comply with a requirement imposed on it by another oversight regulator and the LSB is required to approve and disagrees with the change

8. While most other Approved Regulators are also regulated by OPBAS and will, therefore, face the prospect of potential clashes of this nature, we are, by far, the most exposed to the fact that the new rules and guidance fail to make express provision for the LSB, in reaching its own decision, to take into account the requirements of other oversight regulators. We believe that the new Rules should allow some recognition of obligations created by other oversight bodies that might not sit comfortably with the eight objectives; this can in particular affect the common disciplinary process applied across all regulated areas.

9. To this end we would recommend that rule 9(2) be amended in the final sentence to include "or where they are required by another oversight body, the steps taken to mitigate any adverse impact on the regulatory objectives". Equally, we would suggest that rule 10(g) be extended to reflect the converse situation as well – where an alteration of regulatory provision by an external regulatory body has an adverse effect on the regulatory objectives – and require that details of consultation with both LSB and the regulatory body and proposed resolution and mitigation be included.

10. We would also observe that section 54(4) of the Act allows the LSB to directly engage with other oversight bodies to effect resolution, and this may be a preferable path, similar to that recommended by the BEIS White paper on audit reform.[1]

[1] Restoring trust in audit and corporate governance March 2021 paragraph 11.1.24

QUESTION RESPONSES

Question 1: Do you have any comments on the above draft rules 1 to 4? Do you have any comments on the associated draft Guidance?

11. We note that under Rule 4 a regulator "must have regard" to the guidance given in accordance with section 162 of the Act. While, in principle, we are comfortable with the guidance being an important explanatory guide, it does require flexibility of the oversight body in the application of the guidance. Different regulators will approach certain aspects in different ways according to their regulatory structure and other regulatory responsibilities. We believe that the guidance should be regarded as informative but not mandatory. The model verb "must" does convey an element of mandate and therefore we believe that the use of "should" may be more appropriate in this context.

Regulatory board involvement

12. As noted in the introductory comments above, paragraphs 17 and 18 of the Guidance appear to suggest that regulatory boards should be signing off all rule change applications, including all requests for exemption directions, as part of a process of quality assurance of applications and rigorous internal governance. While we can understand the need for this level of assurance to be applied for major policy changes, we do not consider the requirement for this process to be followed for exemptions to be appropriate or proportionate. We believe that ensuring the regulatory board papers address the statutory objectives and that the application is available for members of the board to review should they wish to do so is a more effective means of securing the outcome. Whilst it may be that this is what is intended, the wording of the guidance could perhaps be improved to that effect.

Definition of regulatory arrangements

13. We have noted that the guidance at paragraph 23 places the emphasis on the content or intent of the policy or guidance, rather than what a document is called, in determining whether it falls within the definition of regulatory arrangements. We welcome this confirmation but believe it should be extended also to confirm that documents which might be entitled 'regulations' may also not fall within the definition of regulatory arrangements even if they impose mandatory requirements within a voluntary scheme. For example, our Practice Assurance Regulations may apply to a practitioner who is also licensed for probate, yet these are voluntary regulations determined in part by the professional body. Without this further clarification, the guidance risks bringing our regulation of accountants within the remit of the LSB. It is also open to interpretation whether documents such as our Guidance on Sanctions for regulatory and disciplinary committees would fall within the current definition without further clarification. We do not believe that such an extensive document which provides guidance on starting points for sanctions – in order to improve consistency – should fall within the ambit of regulatory arrangements.

14. As we have noted in our General Comments, we believe there needs to be greater flexibility in the guidance to recognise the oversight of other bodies and this should include exempting regulations and guidance that are incidental to the role of the licensed practitioner, perhaps along the lines of financial services advice provided under part 20 of the Financial Services and Markets Act 2000.

Question 2: Do you have any comments on the above draft rules 5 and 6? In particular, do you have any comments on the information required to be included in applications or requests for exemption specified in Section E (rules 8 to 13) and rule 17 of the draft Rules? Do you have any comments on the associated draft Guidance?

15. The new section E is at the heart of the proposed processes and has considerable detail attached to it. Whilst we recognise that each of the headings are key elements within an application, the level of detail seems to us to be in excess of what might reasonably be required in most cases.

16. Where the proposed changes fundamentally affect the way that regulation is applied, we can see the need for considerable thought and evidence being required to support this. However, where proposed changes are procedural in nature or amendments are being made for clarification purposes, we cannot see how the requirement for so much detail is consistent with any of the elements of section 28(3) of the Act or section 22 of the Legislative and Regulatory Reform Act of 2006 or the conclusion reached by the LSB in paragraph 64 of the consultation that this process complies.

17. The LSB has ensured, through the revisions to the IGRs, that each regulator has an independent board which is competent to exercise regulatory oversight, promoting the statutory objectives. In directly intervening and vetting in such detail rule change applications for relatively minor changes, the LSB risk effectively adopting the role of the regulatory boards and becoming direct overseers of function.

18. We welcome the reference at paragraph 28 of the Guidance to the ability of a regulatory body to consult with the LSB in advance of an application to determine whether a full rule change application is required or whether the changes may be dealt with by way of an exemption direction. However, we believe that this pragmatic approach will need resource within the LSB of sufficient authority to be able to give specific, constructive advice rather than responses which are general in nature or which still leave a risk that an application for an exemption direction might be rejected after considerable work has gone into preparing and submitting such an application. Otherwise, this could lead to a mutual dissatisfaction with this process.

19. We note that Rule 11 and the associated guidance indicate that a regulatory body will need to explain why it thought that a decision not to consult on a change to regulatory arrangements was a reasonable and proportionate approach. While we have no issue with this requirement, we believe from our experiences to date that it would be most helpful and constructive if regulators could agree at the outset with LSB staff whether there is a need to consult, the breadth of those who should be consulted and how long any public consultation should last. While we understand why, previously, LSB staff have been reluctant to provide any specific guidance on this for fear of fettering the LSB Board's subsequent discretion in approving an application, we would ask whether, in the context of the new arrangements, the LSB Board might consider delegating decision-making on consultations to senior LSB staff within criteria set by the Board. If this is not possible, we believe the guidance needs to be more definitive as to what is required. Otherwise, regulators will continue to be concerned, even if they have consulted, that this will retrospectively be deemed to have been inadequate and delays will occur in making changes which might be important to introduce.

Question 3: Do you have any comments on draft Rule 7 above? Do you have any comments on the associated draft Guidance?

20. We have no immediate comments on the time limits themselves. We do have some concerns on the timing of application, approval and interfaces with other regulators and government bodies, notably the Privy Council. In our particular circumstances, we believe that the process would be much better managed through the application process being expedited before a change to our regulatory arrangements is approved by the Privy Council rather than after it, even if such approvals would then be conditional on Privy Council approving the changes.

21. We note that the LSB now specifies in each Decision Notice when it received the final application from a regulator and does not reference any of the prior communications with the regulator relating to the application or the receipt of draft applications. In reality, the interaction between the LSB and the regulator can be over a period considerably longer than 28 days with the prior communications. We believe that it would be more transparent to reflect that in the notice, even if the formal clock did not start till the final submission had been agreed as that and that the LSB therefore were still meeting the deadline required by paragraph 21(3) of Schedule 4 to the Act.

Question 4: Do you have any comments on the process for requests for exemption? Do you have any comments on draft rules 15 to 17? Do you have any comments on the associated Guidance?

22. The exemption process does provide a more proportionate response to minor alterations. We note that the consultation and the draft rules and guidance refer to paragraph 19(3) of Schedule 4 to the Act but do not actually set out clearly the normal bases upon which an exemption might be sought and applied.

23. With the greater disclosure and compliance burden placed on regulatory bodies through the main application process, it is important that this process is available for most rule change applications where they are not far-reaching in their impact and application. Given the significant work which will have to go into a full application in the future, we believe it would be beneficial for the exemption process to be more widely used in order to meet the requirements of proportionality and targeting required under the better regulation principles. Indeed, this would be consistent with the parliamentary debates around the powers of the LSB to approve regulatory arrangements when the Act was debated in both Houses and the assurance given by Ministers in both Houses that the LSB's role would be 'light touch'.

24. In the House of Lords debate on 18 April 2007, on the power to approve changes to regulatory arrangements, Baroness Ashton confirmed that the Government did not want this process to be *"bureaucratic"* and that there was an expectation that the LSB would act quickly to indicate where it did not need to see changes which were being made or that it could deal with them very quickly.[2]

[2] https://www.theyworkforyou.com/lords/?id=2007-04-18b.223.9

25. On 19 June 2007, when the matter came back to the Commons, the Under-Secretary of State for Justice responded to further challenges in Committee to the proposals around the LSB approving changes to regulatory arrangements as follows: *"I understand that there is anxiety over the need to ensure that the board operates in a proportionate fashion. I agree that it should operate that way and that it would go against that principle if we were to create a system that encourages micromanagement by the board. Equally, we do not want to add unnecessary delay or inefficiency to the day-to-day operation of the regulatory regime, but I do not consider that the current arrangements under schedule 4 will have either of those".*

26. We believe that it would be beneficial for the Guidance to set out clearly the LSB's expectations and to enable the applicant to comply with rule 17(d) (explaining why the exemption is being sought). If this does not happen, applications will continue to be speculative which will be frustrating both for the regulator and LSB staff. Indeed, in a similar vein to our answer to Question 3, it would be most helpful if LSB personnel could give a clearer steer as to when an application for an exemption direction may be appropriate at the pre-application phase (perhaps, again, under delegated powers within specific criteria set by the LSB Board). While it is noted at paragraph 92 of the Guidance, and understood, that any informal feedback at the application phase does not fetter the LSB's discretion, we believe that this should not preclude the staff in the statutory decisions team from being able to give a much firmer, more reliable steer as to which track the application should follow. It is in everyone's interest and, indeed, in the public interest to avoid any unnecessary and wasted work by regulators in order to allow regulators to operate as efficiently as possible.

27. We note that paragraph 84 of the Guidance indicates that the exemption process may only be used for minor or non-controversial changes, or where time is of the essence. It then specifies the content of the application, which must include detail of the proposed alterations, their purpose and intent, an assessment of the likely impact, timescales for implementation, details of consultation undertaken and how we will monitor and evaluate the changes once in force. However, while evaluating the impact of a change may be appropriate for some proposed rule changes, it may not be appropriate for all applications (e.g. where drafting amendments are made to clarify existing requirements) and so we would ask that all of these elements are not stated to be mandatory.

Question 5: Do you have any comments on the proposals and scope for new general exemption directions?

28. We welcome the proposed introduction of a general exemptions process by the LSB which will enable approved regulators to notify changes of an administrative or consequential nature to the LSB so that it can confirm within 14 days whether the changes are appropriate for the general exemption direction process. This initiative strikes us as a proportionate and sensible process that will enable approved regulators to target resources at the development and delivery of more sensitive and complex changes to regulatory arrangements without undue risk to the regulatory objectives.

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