

27 October 2009

Our ref: ICAEW Rep 114/09

Your ref:

Ms Rosaline Sullivan
Legal Services Board
7th Floor
Victoria House
Southampton Row
London
WC1B 4AD

Dear Ms Sullivan

Supplementary Consultation on proposed rules to be made under sections 30 and 51 of the Legal Services Act 2007

1. The Institute of Chartered Accountants in England and Wales is pleased to respond to your request for comments on your Supplementary Consultation. The Institute welcomes the shifts in approach of the LSB to internal governance as a result of its recent consultations and discussions with interested parties.
2. In this response we have looked in particular at the position of regulators whose members already have main core activities (such as accountancy) which are not reserved legal services. We refer to them as “third category regulators” and welcome an early opportunity to establish appropriate Internal Governance Rules for them. Our analysis has identified a strong need for proportionality in the drafting of rules insofar as they will apply to third category regulators, and we trust this important element will be taken fully into account by the LSB in formulating final rules.
3. We highlight the overarching points of principle at the start of this response, and have put our more detailed observations in the Appendix.

MAJOR POINTS

General support for the IGR principles

4. We note the proposed new Internal Governance Rules or IGR need to be compliant with the Legal Services Act and “remain proportionate for approved regulators, whether with or without representative functions”, and the Institute fully supports this stance.

Differences between regulators

5. Approved regulators may be categorised as

- Current legal services regulators who have representative and regulatory functions, and whose members provide reserved legal services. These are the prime and immediate targets for the new IGR.
- Current legal services regulators who do not have representative functions, and whose members provide reserved legal services¹. These regulators will be mindful of the new IGR, even if the practical impact on their affairs is minimal.
- Prospective legal services regulators who have representative and regulatory functions and whose members only provide reserved legal services as *ancillary to their core business* such as accountancy.
- Prospective legal services regulators who do not have representative functions and whose members do not provide reserved legal services yet - this could be a newly formed entrant to legal services regulation.

Specific regulatory concerns

6. This response looks primarily at the third category of regulator, where the reserved legal service provided is likely to be a minor part of the activities of any individual firm and of the approved regulator. This is in the context of the LSB's stated intent to ensure rules remain "proportionate" and in line with the principles of better regulation. Such prospective regulators have particular IGR issues relevant to them, their members and consumers which are not shared by the other categories listed. Here the IGR requirements could prove a barrier, and so a barrier to the wider provision of reserved legal services.
7. We would welcome further explicit and urgent guidance from the LSB on how it intends to deal with IGR for third category regulators, and are happy to meet with the LSB to debate all pertinent issues.
8. This is a matter of public interest and relevant to other oversight regulators who may need to endorse changes². The IGR guidance could have a major impact on the future organisation and activities of such regulators, their memberships and consumers and in particular any route they may be required to take to secure IGR compliance.

Institutional reorganisation

9. It is difficult, indeed impossible, for such prospective regulators, particularly those in the third category, to accurately predict the potential take up from their members at this stage. They should not be expected to incur substantial costs in restructuring and overhauling their affairs to be IGR compliant as a preliminary measure.
10. Member interest may be insignificant or substantial, but most likely will take some time to reach credible numbers. For that reason it is essential that the LSB clarifies to such prospective regulators *how* it will operate its powers proportionately. Otherwise they will shy away from becoming regulators in the first place, again defeating the wider provision of reserved legal services.
11. Accordingly we welcome the stated intent of the LSB to work alongside each approved or prospective approved regulator to determine IGR implementation and operation. This could

¹ The Council for Licensed Conveyancers and the Master of the Faculties

² For example in the case of accountants, this would be the Financial Reporting Council

overcome any perceived deficiencies in the approved regulator's application of the IGRs at an early stage, for example, the allocation of shared corporate services.

Representation versus regulation outside the reserved legal areas

12. Regulators in the third category will have existing representational and regulatory responsibilities which are totally unrelated to reserved legal services. They may well also have other oversight supervisors such as the Financial Services Authority. In our view, becoming an approved regulator should not affect any of these existing activities (on the assumption that the body was not making representations on reserved legal matters). Some of our detailed points in this response reflect this view.
13. While we realise that this is an issue that may have been extensively debated before, in our view there is no need for a lay majority on the regulatory board of third category regulators. There must of course be lay representation but we do not agree that it should be a majority and we cannot see that this is a requirement of the Act for every regulator. We have dealt with this in more detail in our specific observations below.
14. In the case of the Institute, all of our regulator/disciplinary committees have lay representation and indeed some decisions can only be taken if a lay member is present. We also have lay members on our Professional Standards Board which has oversight of our regulatory and disciplinary functions. Our arrangements have been extensively reviewed by our current regulators (the FSA, Insolvency Service and Professional Oversight Board of the Financial Reporting Council) and none have found the arrangements deficient. The most important point is that those appointed observe the requirements of the Legal Services Act and the Legal Services Board would review the operation of those arrangements as part of its oversight.

We trust these comments are of assistance to the LSB. As stated previously we welcome the opportunity to discuss areas relevant to third category regulators. Please contact me should you wish to discuss any of the points raised in this response.

Yours sincerely

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Appendix

Detailed observations on the proposed rules

We specifically identify some areas, in the order that they occur in the draft rules.

Dividing out “permitted purposes” and the concept of “applicable persons” – see IGR Principle 1 and Practising Fee Rule C

- A. Paragraph 5 of the Practising Fee Rules requires money raised through practising fees to be applied for “permitted purposes” and includes a reference to the new definition of ‘applicable persons’. As mentioned above, a third category type regulator (such as the Institute) has other regulatory functions unrelated to reserved legal services and the permitted purposes.
- B. We believe that these functions, of a regulatory and representational nature, which are unrelated to reserved legal services, may be unintentionally drawn in by the definition of ‘applicable persons’ and the activities listed as ‘permitted purposes’ in paragraph 6. Our concern can be overcome by adding at the end of the definition of applicable persons the phrase ‘in respect of a reserved legal service’.

Definition of ‘regulatory independence’ in paragraph A1

- C. For the absence of doubt we believe that ‘undue’ should be added before ‘control’.

Definition of “Board” in IGR

- D. Given the possible confusion with the regulatory board and that not all instances of board are capitalised we suggest that the term Legal Services Board is used instead of a defined term.

Definition of “lay person” in IGR

- E. Our view is that this definition is overly restrictive for a third category regulator. On many of our current committees we have solicitors and barristers serving a very useful function and as a *third category regulator* we regard them as ‘lay’ persons. This would place an unnecessary burden and be overly restrictive if they were required to be removed. We believe that a lay person for such entities is simply someone who is not a member of the approved regulator.

Definition of “Regulatory board” in IGR

- F. It is not clear what the reference to part 1 of the schedule is, since the table is ordered by principles and some minor clarification is needed.

Definition of ‘Representative interests’ in IGR

- G. In our view, to deal with other concerns we suggest the phrase ‘in respect of reserved legal activities’ should be added to this definition.

Representative and regulatory functions in IGR 7

- H. It should be made clear that the representative and regulatory functions referred to are in respect of reserved legal services, to distinguish third category regulators in particular.
- I. This should also be made clear in respect of the other references in the IGRs.

IGR Principle 1 – governance

- J. We are not clear why there has to be a regulatory body and a regulatory board in every case and nor is it necessary for all. The particular body will be an approved regulator and it should be sufficient that it has delegated its functions to one or more boards.
- K. Where an approved regulator has chosen to create a separate body, as is the case for the Law Society/SRA, there is a distinction between the body and its board. However for others it seems to be an unnecessary addition, the regulatory board should be responsible for carrying out the approved regulators functions. Again we do not believe that the Legal services Act requires this degree of separation and it may not be achievable for third category regulators with existing structures..
- L. Please also see our comments above about lay majorities.
- M. It should be made clear that there is nothing to prevent the regulatory body from consulting with those in the approved regulator who have responsibility for making representations about the reserved legal service that the body is approved for.

Membership of Regulatory Boards - IGR Principle 2

- N. On a minor point, for clarity we suggest the words “of an approved regulator” are added to paragraph E

Performance of Regulatory Functions – IGR Principle 3

- O. We do not believe that line management of staff should, or can always, lie with the regulatory board. In those approved regulators that have not separated their approved body functions into another entity, as well as many third category regulators, it is likely that staff will be undertaking a number of functions, many of which will *not* be related to reserved legal services.
- P. For those third category regulators where reserved legal services are a small part of their activities, having staff dedicated solely to legal services would not be cost effective. For example, within the Institute our review teams deal with regulatory matters in relation to audit investment business and money laundering, It should be sufficient that the management of staff dealing with reserved legal services respects the separation of representation and regulation and that there is a process whereby conflicts can be resolved. We are happy to debate this further with the LSB to establish workable criteria.
- Q. It is also our view that some of the mechanisms outlined for the sharing of resources are bureaucratic. Again, taking the view of a third category regulator, the resources needed may not be great given the number of members who wish to be approved to provide the reserved legal service. Therefore in our view there should be a reference to a proportionate approach in rules A, C and D.

The Approval Mechanism and Funds Application– see Practising Fee Rule D

- R. The processes outlined in this section will be extremely onerous for a third category regulator. It is very likely, as noted above, that early adoption of the facility to provide a reserved legal service will be slow.
- S. Therefore in the early years it is unlikely that the practising certificate fees will cover all the costs associated with the regulation of those members. Also, as noted previously, staff will be undertaking a number of activities, not all related to reserved legal services. To maintain detailed cost records so as to arrive at an accurate practising certificate fee will drive up the costs to be recovered for no real benefit.

T. Provided the LSB is satisfied with the totality of the arrangements of a third category regulator and can see that the income from practising certificates is not being used the fund the body's other activities, we believe that the LSB should approve the fee with the minimum of process. We see nothing in the Act that prevents this approach.

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