



PROPOSED INTERNAL GOVERNANCE RULES

Issued 12 June 2019

ICAEW welcomes the opportunity to comment on the Proposed Internal Governance Rules (IGRs) issued by the Legal Services Board (LSB) in October 2018.

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This response dated 17 January 2019 reflects the views of ICAEW as a regulator. ICAEW Professional Standards is the regulatory arm of ICAEW. Over the past 25 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 our regulatory duties we are subject to oversight by the FRC's Conduct Committee, the Irish Auditing and Accounting Supervisory Authority (IAASA), the Insolvency Service, the FCA and the Legal Services Board.

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 2,800 firms and 7,500 responsible individuals under the Companies Act 2006.
- It is the largest Prescribed Accountancy Body (PAB) and Recognised Accountancy Body (RAB) for statutory audit in Ireland, registering approximately 2,800 firms and 7,500 responsible individuals under the Republic of Ireland's Companies Act 2014.
- It is the largest single insolvency regulator in the UK licensing some 800 of the UK's 1,700 insolvency practitioners as a Recognised Professional Body (RPB).
- It is a Designated Professional Body (DPB) under the Financial Services and Markets Act 2000 (and previously a Recognised Professional Body under the Financial Services Act 1986) currently licensing approximately 2,200 firms to undertake exempt regulated activities under that Act.
- [It is a Supervisory Body recognised by OPBAS for the purposes of the Money Laundering Regulations 2007 dealing with approximately 13,000 member firms.]
- It is designated an Approved Regulator and Licensing Authority for probate under the Legal Services Act 2007 (the Act) currently accrediting approximately 300 firms to undertake this reserved legal activity.

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INTRODUCTION

General approach

1. ICAEW welcomes the LSB's initiative to improve the existing Internal Governance Rules (IGR) and its willingness to consult on amendments to the proposed new rules following its review of the responses received to its last consultation.
2. Whilst ICAEW agrees with the amendments the LSB is proposing to make to the IGR as these were requested by ICAEW in its last consultation response; ICAEW, as explained below, is disappointed that the other changes requested by ICAEW have not been made. ICAEW therefore remains concerned about the overall approach taken by the LSB which has resulted in the production of prescriptive rules; even more prescriptive guidance; and lack of definitions of important terms.

Proposed rules

3. ICAEW is pleased to see that the revised rules now more accurately acknowledge and reflect an Approved Regulator's statutory role which requires it to supervise and monitor the regulatory body to which it has delegated its statutory responsibilities. However ICAEW still believes that the level of prescription will make compliance for Approved Regulators unnecessarily difficult in certain areas. ICAEW is of the opinion that a re-formulation of some of the rules and guidance into principles with the onus on the regulators to demonstrate that they comply would have been a better way forward in ensuring satisfactory compliance.

The need for additional clarity

4. ICAEW is also of the opinion that there is a need for clarity, not just in the IGR, but also in the LSB's designation rules. As the LSB is aware, the Lord Chancellor has recently refused to accept that the LSB's current IGR are the correct test for regulatory independence for designation applications but rather rules made under schedules 4 and 10 of the Act which do not exist. This is despite the fact that the LSB makes it clear in its Decision Notices that the IGR are the test it applies when deciding whether an applicant's internal governance arrangements are sufficiently independent. There is clearly therefore a need for further clarity in the LSB's rules on this issue.
5. Schedule 4 and 10 of the Act require the LSB to "make rules specifying how it will determine applications" and that these rules must ensure the applicant has exactly the same independent internal governance arrangements as section 30 of the Act requires of the IGR (the test of prejudice).
6. However, the current LSB designation rules made under schedules 4 and 10 of the Act simply state: *"These rules are to be read in conjunction with the 2007 Act, together with any other relevant provisions made by or by virtue of the 2007 Act, or any other enactment, rules, policies or guidance produced by the Board from time to time"* (Rule 6 (schedule 4 applications) and rule 5 (schedule 10 application)). The rules made under schedule 4 and 10 therefore do not specifically deal with independence of an applicant's internal governance rules but rather rely on 'other' rules produced by the LSB. They are therefore too vague and ambiguous. They should specifically state what rules are applied to ascertain independence of internal governance arrangements in designation applications i.e. the IGR.
7. Therefore, we believe that the introduction to the Rules should make clear that the IGR apply in respect of;
 - ongoing obligations by AR's in the conduct of their governance under section 30 of the act
 - any application to be designated as an authorised regulator under schedule 4 of the act
 - any application to be designated a licensing authority under schedule 10 of the act
8. This is particularly important as there is no provision in the Act to appeal a decision to refuse a designation application. The only option available to an applicant to challenge such a decision is judicial review which does not judge the merits of such a decision.

9. To be more explicit in the rules would make applications more certain (or at least more difficult for the Lord Chancellor to refuse on independence grounds).
10. A second observation we have is through the text of the original IGRs and in the latest draft amendments, the phrase “is and is seen to be (independent)” is used a number of times. It was noted in the judgment of the appeal to the permission hearing in ICAEW v Lord Chancellor that perception is not part of section 30 requirements. It therefore should be used in context and not as a sole determinant.
11. In the executive summary it is suggested that “Consumers and the public must have confidence in legal services if regulation is, and is seen to be independent.” We consider this a strange comment not least because regulatory independence is not first and foremost in the minds of the consumer when acquiring legal services and secondly we query as noted above the regulatory obligation around perception.

Conclusion

12. In conclusion therefore, ICAEW believes that, in light of all of the regulatory objectives in the Act, it is important that ICAEW and other professional accountancy bodies remain part of the regulatory framework for legal services. This is because many of the firms regulated by us for probate are relatively small and many would give up this line of work rather than take on the additional compliance costs of dealing with two regulators if ICAEW were to withdraw from its regulatory role as a result of any difficulties in complying with the final version of the new rules. For the reasons set out in our last response to the LSB’s consultation on its proposed IGR, ICAEW does not believe that this will be the case.
13. However, whilst a change to the independence test in rules 1, 4, 8 and 10 clearly now acknowledges the role of the Approved Regulator as a supervisor of the regulatory body to which it has delegated its statutory regulatory responsibilities, it is disappointing that the rules and guidance remain so prescriptive and that important terms are not defined.
14. ICAEW would also urge the LSB to make it clear that the rules referred to in the designation rules relating to independence of regulatory arrangements are specifically the IGR to avoid confusion and add more transparency and certainty to the designation application process in the future.

RESPONSES TO SPECIFIC QUESTIONS

Q1: Do you agree that the amendment to Rules 4, 8 and 10 as set out in this document should be adopted into the new IGR? Please provide your reasons

15. ICAEW is pleased to see that the LSB is consulting on a change to rule 1 that we requested in our response to the LSB’s last consultation on its proposed new IGRs. We pointed out in our response that the wording of rule 1 did not accurately reflect the requirements of section 30 of the Act and the intent of Parliament as it included a test of ‘influence’ rather than ‘prejudice’.
16. We therefore agree with the LSB’s proposed amendment to rule 1 ie, the replacement of the word ‘influence’ with the word ‘prejudiced’ and the removal of the requirement for an Approved Regulator to separate its regulatory functions from representative ‘interests’ as well as representative functions. We believe the amended rule 1 now reflects the intention of Parliament and the requirements of section 30 of the Act.
17. With regard to the proposed changes to rules 4, 8 and 10, as these are necessary to ensure consistency with rule 1, we also agree with these changes and are pleased to see that not only, again, has the word ‘influence’ been replaced with ‘prejudice’ but the LSB has removed the requirement that an Approved Regulator’s views can only be taken into account when given in response to a regulatory body’s consultation.
18. We believe these rules now more properly acknowledge and reflect an Approved Regulator’s statutory role which requires it to supervise and monitor the regulatory body to which it has

delegated its statutory responsibilities. They will also enable a regulatory body to access technical expertise and know-how provided by the Approved Regulator which ensures quality decision-making.

19. ICAEW is however disappointed at the decision by the LSB not to amend the rules and guidance to make them more outcomes focused. This seems to run directly contrary to the outcome of the LSB's initial consultation on changes to the IGR and the expressed intent from the LSB to ensure that the new Rules would be principles-based and outcomes focused.
20. The clear focus of the proposed IGR still appears to be on the 'inputs' to the governance arrangements of the legal services regulators and on prescribed ways of ensuring the independence of their governance arrangements. ICAEW is of the opinion that the IGR should, instead, define key principles which would allow the regulators to adjust their existing arrangements in whichever way works most practically and efficiently for them in order to be able to demonstrate to the LSB that it complies fully with that principle. There is a risk that the LSB Board will be swamped with a series of reasonable applications under the saving provisions of rule 16 and a consequent dilution of intent in the other rules.
21. ICAEW is also disappointed to see that the LSB has failed to adopt ICAEW's recommendation that it provides clarity by defining important terms in the rules such as 'regulatory body' and 'involved in a material way'.

Q2: Does the proposed revised guidance on Rules 4, 8 and 10 at Annex A provide sufficient detail to help you to interpret and comply with the proposed revised versions of Rules 4, 8 and 10? Please provide specific comments on any areas of the proposed guidance for Rules, 4, 8 and 10 where further information would improve clarity

Guidance on Rule

22. As outlined in our last consultation response, the guidance on Rule 4 is unclear with regard to the definition of a Regulatory Body. The wording of the guidance under the sub-hearing Governance & Structure states [emphasis added]:
"Determining its own governance and structure, essentially requires that the regulatory body has control over its constitution including:
 - *Its hierarchy*
 - ***Its decision-making processes***
 - *The make-up of its board and committee(s)*
 - *Election of members*
 - ***The division of power between those bodies and its executive***
 - *Its conduct rules, and*
 - *Terms of reference for its bodies*
23. It is unclear where the control lies. For example who decides on the division of power between the regulatory board and the executive and on the processes for decision-making? ICAEW is of the opinion that the guidance needs to be much clearer on these issues.

Guidance on Rule 8

24. ICAEW repeats its concern about the lack of definition of a regulatory body and would further add that the guidance on this rule needs to make clear that appointments and terminations should not just be made independently from the Approved Regulator with a residual role but should also be made independently from the executive of the regulatory body for the reasons outlined for rule 4 above.