ICAEW REPRESENTATION 04/17
REGULATORY REPRESENTATION

A vision for legislative reform of the regulatory framework for legal services in England and Wales

ICAEW Professional Standards welcomes the opportunity to comment on the document *A vision for legislative reform of the regulatory structure for legal services* in England and Wales published by the Legal Services Board (LSB) on 12 September 2016, a copy of which is available from this link These comments, set out in this representation letter of 11 January 2017, have been considered in the light of this document and the *Legal services market study* issued by the Competition and Markets Authority (CMA) on 15 December 2016.

The Institute of Chartered Accountants in England and Wales
Chartered Accountants' Hall
Moorgate Place
London
EC2R 6EA UK

T +44 (0)20 7920 8100
F +44 (0)20 7920 0547
DX 877 London/City
icaew.com

ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 147,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

ICAEW was granted status as an Approved Regulator and Licensing Authority for the reserved legal service of probate in August 2014, and since that time has both authorised accountancy firms and licensed them as Alternative Business Structures (ABSs) for probate services.

In addition ICAEW as a regulatory body is;

(a) the largest Recognised Supervisory Body (RSB) and Recognised Qualifying Body (RQB) for statutory audit in the UK, registering approximately 3,000 firms and 8,000 responsible individuals under the Companies Act 1989 and 2006.
(b) the largest Prescribed Accountancy Body (PAB) and Recognised Accountancy Body (RAB) for statutory audit in Ireland, registering approximately 3,000 firms and 7,500 responsible individuals under the Companies Act 2014
(c) the largest Recognised Supervisory Body (RSB) for local audit in the UK, registering approximately 10 firms and 100 responsible individuals under the Local Audit and Accountability Act 2014
(d) the largest single insolvency regulator licensing some 750 insolvency practitioners as a Recognised Professional Body (RPB) under the Insolvency Act 1986 out of a total UK population of 1,700.
(e) a Designated Professional Body (DPB) under the Financial Services and Markets Act 2000 currently licensing approximately 2,300 firms to undertake exempt regulated activities under that Act.
(f) a Supervisory Body recognised by HM Treasury for the purposes of the Money Laundering Regulations 2007 dealing with approximately 13,000 member firms.

In discharging these duties ICAEW 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.

For more information, please contact Duncan Wiggetts, Executive Director Professional Standards
duncan.wiggetts@icaew.com icaew.com

Executive summary

1. The Legal Services Act 2007 (the Act) initiated a major change in the way the legal profession was regulated. The Act has been successful in securing some change, but further evolution was rapidly seen as being inhibited by the provisions of the act

2. A number of initiatives have taken place since 2012, the most recent of which has been a paper issued by the Legal Services Board (LSB) setting out their vision as to how regulatory reform of legal services should proceed (the vision paper). This paper has addressed issues across a number of areas and put forward recommended changes. These include the structure of regulation process as well as the focus of regulation.

3. The vision paper was not a consultation. However we believe it is an important document that should be responded to. We commend the LSB for taking the initiative here in moving forward the debate and we welcome a number of the proposed changes they have put forward. However we consider the recommendations around single regulator and separation of the regulatory arms of professional bodies from their representative arms counter-productive and lacking an evidential base for change.

4. The vision paper sets out six key areas for discussion. We have commented upon in these in turn below taking into account the additional observations of the Competition & Markets Authority (CMA) in their recently issued report.[1]

Statutory objectives

5. We were initially of the view that the eight statutory objectives were difficult to work with, but we have come to recognise that each has an important dynamic in the functioning of the service of law. We caution against setting over-arching objectives, but if public interest were to be pursued this would need to be clearly defined. Indeed we believe the LSB has a role to play in articulating more clearly what each of the objectives means in practice and this should then help reduce the perceived risk of inconsistency in application.

Scope of regulation

6. We agree that the use of the six reserved services coupled with regulation of title as a means of regulation is outdated, but we have a number of concerns about the alternatives being mooted to replace that scope. In particular the apparent move to withdraw a swathe of regulation from large areas of legal service provision, even if it is low risk, seem to us to be a major step backwards and strips the consumer of protections. There seems to be a disregard of the role of the legal profession and, also, the accountancy profession in establishing a series of standards that support the underlying middle market on a proportionate basis. The consumer could potentially be faced with a huge difference in levels of service and protection depending on subject matter of the issue.

Focus of regulation

7. The proposed focus set out in the vision paper is to place greater emphasis of regulation of activity and less on regulation of title. As in the case of scope we believe the role of the professions in providing a proportionate regulatory space under regulation of title is not given sufficient consideration. The concentration on “after the event” regulation rather than “up front, before and during the event” regulation as a means of proportionality is in our view counter-productive and not in line with best regulatory practice. The consumer is better served if prevention rather than cure is provided as a market remedy. We would, however, concur with the view of the LSB that the rules around privilege are confusing and lead to a distortion in the market, and should be applied on a consistent basis across all suppliers of the same service.

[1] Legal services market study final report by the CMA issued 15 December 2016

Independent regulation

8. We fully support the need for "independence" of the regulatory function within the bodies authorised to regulate, but we do not understand the vision paper's preoccupation with the physical / legal separation of regulatory work from representative bodies as a necessary step in achieving that objective. We are concerned that the important benefits of the existing structures do not appear to have been given any proper consideration in the vision paper before a conclusion is reached that separation is a panacea for all regulatory ills.

9. The vision paper fails to recognise, and take into account, that the accountability of the regulatory arm to the member bodies is as much a strength as it is a weakness. Furthermore, provided appropriate safeguards are in place, including active supervision by an oversight regulator, the Government's aims around red-tape management and small business appeal champions for business are sustained through this internal challenge to excessive or restrictive regulation. The tensions between oversight body and the Approved Regulator (AR), and between the AR and its representative counter-part are key moderators in ensuring that regulation is tight, focused, proportionate and commercially practical.

10. The vision paper also fails to recognise the fact that many other professional services are regulated successfully and efficiently without the need to enforce separation of the regulatory function within those authorised to regulate. ICAEW may be a very new regulator of legal services, but it has been authorised as a regulator of three other professional services for a considerable period of time (audit, insolvency and investment advice) and none of its oversight regulators has sought to impose a requirement for separation. Indeed, there would be no sound evidential basis to do so.

11. An independent review and update of the governance and independence of ICAEW's regulatory arrangements in the last three years sought to apply the best in international and UK practice and are in our view fit to meet the outcomes sought under section 30 of the Act. In addition annual inspection reports by oversight regulators supervising those areas of regulation are publicly available and no recent report has sought to raise any concern regarding the independent functioning of those regulators.

12. We consider that the current difficulties mentioned in the vision paper to support the need for separation to be localised problems within one or two legal services regulators which can be addressed by alternative means, most notably through improved governance arrangements which the LSB is itself well-placed to steer through its powers under section 30 of the Act. In addition as regards practising certificate fees, we believe more imaginative revenue collection processes can be applied enabling the funding of the regulatory bodies without necessarily making it a condition of licensing or needing the approval of their linked member body.

13. As in the case of scope and focus, we have concerns about the role of voluntary regulation and the regulation of non-reserved areas of legal services where the lawyers and accountants provide a layer of quality control and assurance to the consumer and public at large on the strength and quality of these services. Separation would call into question the stewardship and relevance of this regulatory activity, if not statutory, and this might be taken in house by the representative arms without the LSB oversight. This could result in doubling of regulatory fees and increased complexity in the market place.

14. As ICAEW's current structure is considered suitable by its other oversight regulators, and it currently does not have a significant input in the legal services market, the imposition of separation to achieve independence could force ICAEW to re-consider whether it wishes to remain as a legal services regulator. We believe this would be a retrograde step when it currently licenses half of the multi-disciplinary practices licensed as ABSs under the Act. It would also be setting back the UK in the evolution of professional services in terms of competitiveness in overseas markets at a critical time for the economy and would run contrary to the desire of the CMA to have strong competition in the provision of professional services' work.

Consumer representation

15. ICAEW has not had significant engagement on this area, though it does have a number of feedback mechanisms to gauge this. We are concerned in the vision paper that the "consumer" is not defined and if anything seems to focus heavily on the vulnerable consumer. The reputational risk associated with the larger consumers and suppliers is apparently not considered. Give the importance of the role of the legal services market in terms of export we would suggest that debates around consumer should include the informed consumer and big business as well as the vulnerable in order to ensure that the reputation of the legal services market is not undermined in public and international confidence, and that they are served equally as well.

Structure of the regulator

16. We do not agree with the suggestion made by the vision paper around single regulator. We believe there are inherent political and judicial risks associated with such a structure, and that it would suffer from complacency and lack of accountability. In our view the models afforded by the regulation of audit, approved by the EU and BEIS, offer a structure which is competitive, facilitates a race to the top rather than the bottom, and ensures the consumer and public receive a trusted and quality service by the practitioners that are licensed and overseen.

Conclusion

17. The LSB vision paper is to be commended for taking forward the debate on the future of legal services regulation. There are important steps put forward which we would endorse. However we believe the apparent side-lining of the professions in making some of the recommendations misguided and believe they are an integral part to the solution rather than a problem to be removed. In particular, we believe the quality of service and consumer protections across a number of lower risk legal services could be compromised and that the collateral damage associated with independence of function too great a risk.

18. We agree with the suggestions made by both the LSB and CMA that many of the issues can be addressed within the existing process, but greater unfettered power needs to be given to the LSB to initiate those changes and monitor the work of the front-line regulators. In addition, we believe that any consultation exercise on independence needs to be more thoroughly thought through and should take into account how other professional services are currently regulated. It should have clearer outcomes and should consider other alternatives fully before the matter is sent out for consultation. Indeed we would question whether the LSB utilising its powers under section 30 should already be leading in addressing this issue and it should not be a matter of involving the Ministry of Justice (MoJ) at this stage.

Background

19. The supply of legal services in England & Wales has seen many changes in the last 8 years since the passing of the Act. The Act sought to change the way legal services were offered and to provide openness and transparency in the way legal services were provided. Although the Act has been quite successful in bringing about change, it is becoming a victim of its own success and starting itself to be a barrier to the development of the markets.

20. In 2013 a call for evidence on the operation of the Act met with mixed responses, and proved inconclusive, so much so that the then Lord Chancellor Chris Grayling in 2014 summoned the legal services regulators to his office to encourage them to initiate some more practical suggestions. The legal service regulators with the aid of moderation by the LSB and Professor Mayson accordingly produced two letters to the Justice Minister Shailesh Vara in July 2015 setting out a series of tactical and strategic suggestions around the future of the framework. [2]

21. ICAEW was a participator and contributor to these letters, but found themselves, as did other regulators, in a minority on certain issues. As a consequence the strategic letter was caveated with the acknowledgement that not all of the proposals were the result of a unanimous viewpoint.

22. In July 2015 shortly after these letters were issued the Lord Chancellor (Michael Gove) advised that he was proposing to undertake a full review of the regulation of legal services during the lifetime of the new parliament. The timing of this review is uncertain now given the developments around Brexit and the Lord Chancellor's own exit.

23. In September 2016 the LSB launched its vision paper at the Westminster Forum. The vision paper took forward the proposals contained in the July letters to the justice minister and explored what further options might be. We recognise this as an important step forward and support the LSB in seeking to develop the options for change. This does not however necessarily mean we agree with all the content, and we have therefore taken the opportunity in this representation to explore some of the observations and make clear our concerns where we believe the approach is ill-directed.

24. The Competition & Markets Authority (CMA) published the results of their review of the supply of legal services in England and Wales on 15 December 2016. This review referred to possible changes in the regulatory structure, suggested that many of them could be resolved within the existing framework, and suggested that issues relating to independence should be considered by the Ministry of Justice (MoJ) by way of consultation.

LSB Vision

25. The LSB vision paper sets out 6 key headings where they believe the framework could be improved. These are;

    a) Regulatory objectives
    b) Scope of regulation
    c) Focus of regulation
    d) Independent regulation
    e) Consumer representation
    f) The structure of the regulator

26. We respond to each of these views in the comments below.

---

[2] Letter to Shailesh Vara 6 July 2015 Legislative options beyond the Legal Services Act 2007 http://www.legalservicesboard.org.uk/what_we_do/pdf/20150727_Shailesh_Vara_MP_From_MPitt.pdf and Letter to Shailesh Vara 3 July 2015 Deregulation in the legal services sector to better support innovation and growth. http://www.legalservicesboard.org.uk/what_we_do/pdf/20150720_Joint_Ministerial_Submission_Covering_Letter.pdf

Statutory Objectives

27. On our initial engagement with legal services regulation, we shared the view of many that the eight statutory objectives were confusing and conflicting and open to wide interpretation. However having worked with the requirement for two years as a regulator we have come to understand the dynamics associated with them and the role of the regulator in applying them in practice. We agree with the LSB's observations that the regulators have the responsibility to resolve tensions in the application of these objectives.

28. We have some sympathy with the view of the LSB that there should be an over-riding objective, and the public interest objective is a logical choice for this. However we do not think consumer interest is itself an objective that should override other equally compelling objectives such as the rule of law and access to justice. The view of the CMA to add in competition to public interest and consumer interest just further adds to the confused picture and seems to place the certainty and quality of law on the back seat. This cannot be appropriate least of all to public interest itself.

29. We note the brief discourse in the vision document regarding "objectives" and "duties" and the conclusion that there is not a great deal of difference between them. The observations around the diversity objective and its limited relevance in the light of the Equalities Act 2010 should have picked up on the obligations in that Act around "due regard" and case law around how that should be applied. In our view the expectations of the Act require a due regard to each of the eight statutory objectives and none of them should be disregarded in any regulatory decision.

30. It has been a criticism of the many objectives that they make for inconsistency between the regulators in their application and weighting. In our view it is the role of the oversight body to set out their understanding of the key elements of these objectives and expect the regulatory bodies to abide by that interpretation. The LSB have done this to a certain extent for diversity and consumer interest, but there has been little commentary for example on access to justice and the rule of law.

31. That is not to say that the regulatory bodies do not have a role in pushing back on proposed interpretations. For example the commentary on the diversity objective by the LSB is in our view taking too narrow a view on the application of that objective by limiting interpretation to being centred around the Equalities Act whereas we believe it is as relevant to the market place and forms of body offering legal services such as alternative business structures.

32. However in the debate around objectives and an over-arching override it is disappointing that the "Public interest" itself is not defined in the vision paper. The experience of the FRC with the Deloitte MG Rover case[3] indicates this concept needs care in deployment and a clear articulation if it is to be effective as a regulatory instrument. The reputation of the legal profession abroad, as was suggested in the letter to Shailesh Vara, is one illustration, but by no means is a comprehensive analysis of this complex ideal. ICAEW in a policy paper[4] has explored the concept further and shown that there are many facets to it. If the LSB are intent on using the objective as an override, particularly in the context of the other seven objectives, there needs to be more guidance provided to the regulatory bodies.

Scope of regulation

33. We agree with the LSB that the fixed list of six reserved activities is not the result of any recent, evidence-based assessment of the benefits or risks created by those activities. We therefore agree that an independent and evidence-based review should be carried out to determine from first principles which activities should attract strong regulation in the future.

[3] Deloitte Touche & Maghsoud Einollahi v The Executive to the Financial Reporting Council 2015
[4] Acting in the Public Interest – A framework for analysis – ICAEW and Markets Foundation 2012

34. We are disappointed however that the decision of the LSB, and indeed to a certain extent the CMA, is to let the boundaries rest there and that all other legal activities should be covered if at all by “voluntary regulation” or existing consumer protection legislation. The LSB vision does not explore the role of the professions in detail or consider them as a mechanism in a proportionate regulatory structure. There is scant recognition for the role of the profession in bringing quality and recompense for the non-reserved legal activities, which the CMA does acknowledge as qualities which support consumer protection and service in the short term and are not immediate barriers to competition.

35. We agree that the consumer currently is pushed towards a high quality service with higher cost through the trust associated with solicitors and the lack of knowledge of alternatives. This may be appropriate in some circumstances, but not in others, and it is clear that some legal advice or support is met with a Rolls Royce service when something akin to a mini (with a much lower cost) is more acceptable to the consumer. The CMA recommendations seeking greater visibility of pricing and explanation of market alternatives will assist in that education.

36. However the competition and diversity objectives require choice at all levels, not just reservation or nothing at all. There needs to be something in the middle that gives the consumer an option and choice to go not for best, but not for least either. The professional hall-mark that is given by the title ”solicitor” or in our own profession “Chartered Accountant” provides the consumer with some assurance that they are being served by people who understand them and their problem and are conscientious about their work and their duty to the consumer.

37. In his speech in 1993 Lord Benson outlined the basic features and role of a profession which are as much relevant today as they were 20 years ago. In particular the focus on standards, regulatory oversight and accountability to their peers by practitioners were seen as key components of the role. The other words the profession itself is well skilled to provide a layer of quality and recompense that is not over-prescriptive but underpins a level of quality which the consumer can rely upon. We believe that in their pursuit of what they see as the necessary separation of the representative and regulatory functions the LSB has chosen to ignore this platform as an option in the determination of scope to the detriment of their vision paper.

38. The same criticism can be levied at the CMA. Although it acknowledges that the current system has some strengths, it believes it not sustainable in the longer term, and seems as a long term remedy to be encouraging a race to the bottom (a phrase it readily uses to describe the attitude of the regulatory bodies) without considering the impact on the supplier choice as a whole.

Focus of regulation

39. The direction of the LSB vision in this area is influenced by the reasoning given in the scope, namely that the focus should be primarily on activity, with regulation of providers only for specific high risk activities. Title is linked to qualification and qualification is linked to professional competency, standards and quality of service. All extremely important in safeguarding the public interest and protecting the consumer. They have a role in in judging quality and therefore making a choice. We feel these important aspects are overlooked by the vision paper.

40. There may be some useful comparisons to be made here with the regulation of the accountancy industry. Insolvency, Audit and Financial Advice are all services that are regulated by statute, whilst other accountancy services are non-reserved and may be provided by non-accountants. The accountancy bodies define themselves by placing additional regulatory responsibility on their members in terms of qualification and adherence to standards. These are reinforced by an inspection regime and an enforcement process for shortcomings which are overseen by the bodies themselves through their regulatory arms. The whole framework has a light touch overview by contractual arrangement with the FRC. It is therefore possible to operate statutory and voluntary regulation side by side with common processes which lead to a low cost oversight model for the practitioner, and a wide range of assurance for the consumer.

41. In this context we believe the concept of before/during and after the event regulation expounded by the LSB in their vision paper[5], and cautiously explored by the CMA in their report[6] is ill-founded and positioned. It is treating regulation as purely a penal mechanism whereas its role in our view needs to be equally if not more so didactic – that prevention is better than cure. This is an approach followed by ICAEW in its regulation of accountancy through CPD and routine regulatory inspections where training is as much part of the inspection routine as is the monitoring of compliance.

42. This is not just a whim of a regulatory body. It is worth noting that the FRC, the LSB's equivalent in the area of audit and accountancy, is in its inspection approach following recommendations of McKinsey in applying a didactic approach "to monitor and promote improvements in the quality of auditing".[7] That quality and improvement is just as important for the consumer of legal services, vulnerable or otherwise, as is a cheap price. The consumer should not be forced to go down the route of challenge and recompense when an up front – before and during the event – process can put in place simple proportionate and low cost standards and controls.

43. We accordingly believe that stronger emphasis should be placed on the prevention mechanisms and that the professional bodies as well as the regulatory bodies are well-placed to apply that. As regards the non-regulated firms offering legal services, the LSB should be looking at setting a series of base minimum standards in consultation with consumer protection organisations and using a light touch oversight mechanism to ensure those standards are upheld in this area of the market.

Privilege

44. We agree with the LSB's view that the present position regarding privilege conflicts with recent developments in the regulatory system.t There should be a level playing field in relation to privilege for all who provide legal advice and services. Privilege belongs to the client, not the provider of legal services, and therefore to afford wider privilege to the clients of some providers over others is unfair to those clients and not in the public interest.

45. The Act does have the merit of providing privilege under section 190 to all those who are licensed for the relevant reserved areas. However it is unfortunate that the definitions used for the reserved services in section 190 are inconsistent with those used in Schedule 4 leading to added consumer and supplier confusion. Privilege should be applied consistently according to the risk of the service and the consumer, not according to the title, though we agree that there should be strong ethical guidelines underpinning its application.

[5] Ibid page 19
[6] Ibid paragraph 6.23
[7] FRC presentation "Monitoring Activities what does it all mean?" 25 November 2016

Independent regulation

46. We endorse both the views of the LSB and the CMA in saying that independence is a key element in building trust in the legal services market. The issue of independence has been discussed at length over the past two years and was a strong message in the letter to Shailesh Vara. It is an important quality that has been applied in the accountancy industry especially with regard to Audit and Insolvency.

47. We note that the CMA report suggests that the Ministry of Justice examine the question of independence as it relates to the regulatory bodies[8], but does not make any direct recommendation on how this should be approached. Indeed though it refers on one or two occasions to "full" independence it does not define what this might look like. On the other hand the LSB in their vision document pitches immediately for separation of the regulatory and representative arms of the bodies in order that independence might be achieved.

48. We find the need to impose separation to achieve independence as the panacea for all the ills in the current framework somewhat misplaced. The objectives set out in section 1 of the Act make no mention of independence; this is not unusual; independence should be seen as an important enabler of the justice system and those objectives, not something to be pursued in its own right at the expense of the objectives. In the area of audit, independence is highly important but it is not to be pursued at the expense of audit quality which is where the markets find greatest assurance.

49. There is an added irony in the Act in that at section 30 provision is made to enable the LSB to make rules around governance that would assure independence. The starting point for this must be the outcomes expected from such a process, and the characteristics of what an independent function might look like. Whilst the LSB's IGRs issued under section 30 attempt to steer a course, the lack of specific high level outcomes together with the limited enforcement powers available to the LSB mean this oversight mechanism appears to be ill-exercised at present.

50. The justification for the separation approach is set out in paragraph 72 of the vision document. It largely replicates the content of the letter to Shailesh Vara. Although ICAEW were a co-signaturee to that document, we had expressed serious concerns about the one-sided considerations regarding the separation approach but had accepted the exclusion of their minority position under the opening paragraphs of the letter that recognised that the regulators were not necessarily unanimous with the proposals.

51. The reasons for ICAEW's concerns were two-fold; firstly the proposal did not in itself resolve the issues that were creating the tensions and secondly the benefits of the linkage between the two arms were only given cursory consideration. These are considered separately in the following paragraphs.

Issues creating tension

52. The principal concerns appear to arise through budgetary constraints and interference by the member body in the regulatory body's strategy and operations. These are peculiar to some of the bodies but not all of them, as is noted by the CMA in their report. What is disappointing is that little thought appears to have been given to identifying solutions to the problems of one or two bodies but instead these problems are used as the excuse or evidence to support the need for separation even on bodies where no concern could be raised about independence particularly in relation to budgetary constraints.

[8] Ibid paragraph 6.80

53. The budgetary debate appears to be centred on the allocation of income from members between the two functions, typically through the practising certificate. In ICAEW this is simply not an issue as the income streams are separate. Practising certificate income flows wholly to the representative arm, whilst the regulatory arm funds its operations from quality inspection and registration fees. A review of the income streams pertaining to the two bodies and the separation of those income streams would seem to be a much more sensible approach without needing to separate the two organisations.

54. The practising certificate issue is important not only in the tension between the two functions but in the setting of entry criteria into participation in the market. There is a perception that that the practising certificate acts as a barrier to entry and compromises the ability of the regulatory bodies to license outside the traditional existing legal firms. ICAEW's structure not only ensures regulatory independence but also, in relation to the regulation of probate and ABS, appears to meet these government objectives. This is because, unlike some of the other legal regulators, our structure ensures that our practising certificate fees and main accountancy qualification are not intrinsically linked with our regulation of legal services and are therefore not barriers to entry to the legal services market. Rather, ICAEW becoming a legal regulator has in fact increased competition and the opportunity for innovative business to enter the legal services market. Non-members and even some members are not required to hold an ICAEW Practising Certificate and those that do, fund the representative side not our regulatory operations

55. The interference in policy is down to weak governance structures. ICAEW undertook a governance review in 2013 under the chairmanship of Sir Christopher Kelly which set out a series of steps necessary for ICAEW to operate as a credible regulatory body in the 21st century. A critical element of these reforms was the ability of the regulatory arm to operate without undue interference from the member arm. At the same time it was recognised that the benefits of the link to the representative body (detailed below) should be retained. A key element is a mechanism for addressing disputes between the two arms without compromising their respective positions, a recommendation made by Lord Hunt in 2011 with regard to the Law Society/SRA governance arrangements but not followed through at the time[9].

56. The suggestion that the current arrangements "distract senior management on both sides from regulatory and representative matters respectively" is both a valid criticism and a worrying direction of travel. Whilst we recognise that the current tensions for certain of the regulatory bodies has created difficulty and delayed certain reforms, the suggestion that separation would get rid of these tensions is in our view optimistic and could paradoxically end up reinforcing entrenched positions. It is surely the responsibility of both the representative and regulatory arms to consider and inform each other's policies and to Act responsibly and in the public interest in doing so. They however should not be exercising override on each other's end position.

57. In paragraph 49 above we refer to the role of the LSB and the deployment of their section 30 powers as a means of addressing the imbalance between the two arms of the professional bodies. We believe the LSB has a role here in setting the key outcomes needed and acting as a point of last resort in the event of an unlikely impasse between the two arms.

58. As well as the areas of governance, transparency of cost and reform delay noted above, the LSB vision notes three other areas where there are issues supporting a separation approach which we would comment briefly on as follows;

[9] The Hunt Review of the Regulation of Legal Services 2009

(a) **Credibility of regulation in the public perception**. There is a risk that regulators at times overestimate their own sense of importance. It is clear from the recent review of client care letters undertaken on behalf of the regulatory bodies[10] that the consumer has little interest in the regulatory structure and a lot of interest in getting a quality affordable service, a point which has not gone unnoticed by the CMA in their report. Independence for them is a useful knowledge point but not one that is relevant except when they need to complain.

(b) **Confusion in government as to which body is responsible for regulatory functions.** In our experience this is not a problem, especially as government tend to wish to engage at both the representative and regulatory level to understand the dynamics, education and enforceability of their regulatory measures. Indeed in some ways the interaction between the two arms enables government to understand the inter-dependencies more clearly.

(c) **Market change is reducing relevance of structure.** Whilst we would not disagree with the observation, we do not see this as an argument for separation. The Act introduced the ability of the regulatory bodies to license firms and individuals which were not themselves members of the relevant representative arm. ICAEW, for its part, amended its charter in 2013 to accommodate this objective of the Act. We are not sure the other bodies have done this and this may be serving to Act as a continued tension. In terms of audit and insolvency, ICAEW and the other accountancy bodies have been licensing non-members for these services for the last 30 years. The recent reinforcement of that framework for audit under the recent implementation of EU audit reforms in the UK[11] demonstrates the flexibility and relevance of the profession in providing a wider market model.

Benefits of linkage

59. In our view there are however a number of strengths to be seen in the continued linkage between the representatives and regulatory arms of a professional organisation;

(a) a continued tension between the organisations that keeps each other on their toes and leads to higher standards and quality in delivery of the regulatory programme and in the adherence of members to regulation
(b) the technical exchange between the two arms is more freely enabled thus leading to quicker assessments and robust advice to the practitioner
(c) the regulatory arm is better able to influence the educational agenda of the membership body to address key regulatory aspects
(d) there is an ownership by the profession to the regulatory process espoused by Lord Benson as part of his definition of a profession in 1992[12]. That ownership results in self and cross-policing by members which would be weakened by total separation. This potentially undermines quality especially in the non-reserved areas.
(e) The regulatory body has accountability to those it seeks to regulate as well as the LSB and consumer

These were strengths that we believed should have been included and considered in the Vara letter and the LSB Vision document. We have provided more detail below to balance up this viewpoint.

[10] Research into Client Care Letters prepared by Optima Research October 2016
[11] The Statutory Auditors and Third Country Auditors Regulations 2016 SI 649 implementing Directive 2014/56/EU of the European Parliament and of the Council of 16 April 2014 amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts and Regulation (EU) 537/2014 of the European Parliament and of the Council of 16 April 2014
[12] House of Lords, 8 July 1992. Referred to in the Hunt Review of the Regulation of Legal Services 2009 page 27

Tensions between organisations

60. The tension between the LSB as oversight body, the regulatory bodies, and the membership bodies is, in our view, a key requirement in the quest for a better regulation framework. The 5 principles are subject to debate and can be considered and challenged through this three tier approach, with the regulatory body acting as the middle man to secure regulation that is fit for purpose yet lean and targeted.

61. The current discussions in Government departments around the red tape challenge, and the determination of Business Impact Targets,[13] have highlighted the level of gold plating that can arise from regulation. The tension we believe works to underpin the government's Better Enforcement Programme and indeed the representative bodies can be seen as acting as the Small Business Appeals Champions[14] acting as a brake to contain the level of regulation applied by the oversight bodies and regulatory bodies. We believe this mechanism can be replicated across to legal services where the LSB, Approved Regulators and the membership bodies provide that tension model. Separation on the other hand would be somewhat counter-productive to this process.

Technical exchange

62. Both the LSB and CMA in their reports note, in passing, the role of technical knowledge within the representative bodies but neither seem to consider this to be business critical. This seems to be an underestimate of the role that technical knowledge plays in the regulatory process, be it at the front end in terms of licensing, during the event in terms of CPD, training and quality inspection and, finally, in enforcement where a firm or partner facing judgement is judged by their peers and not by the uninformed. The representative function has a role in promoting and advising on best practice and the regulatory enforcement mechanisms should be seen as the underpinning of this, not something to be performed in isolation.

63. It is recognised that the technical expertise could be reproduced in a separate regulatory arm. That expertise comes at a cost which effectively doubles up for the practitioner and is to the disadvantage of the consumer and indeed supplying practitioner as the learnings are not as well communicated through the regulatory process as they are through the member training and CPD mechanisms. It also increases cost to the practitioner and thereby to the consumer.

Educational agenda

64. As noted in the previous paragraph, the educational agenda is driven by the representative arm, which also provides training and guidance on best practice. Some of the learnings in best practice come from the inspection programme and complaint function under the regulatory arm, and are better communicated through integration of these in the core training. Separate organisations would not be as fluid in this exchange of knowledge and skill.

Ownership of regulatory process

65. It is not always appreciated the extent to which the consumer receives the benefit of a "quality umbrella" in the supply of legal services and accountancy services in the UK as a consequence of the input of the representative functions. The CMA in their report concede that the current framework does largely work, but is seen as inflexible for future evolution of legal services. Neither they, nor the LSB, consider the role of the professions in any alternative. As a consequence there is a risk that the long term solutions offered would continue to provide a strong regulatory structure for the high risk revised list of reserved activities, but result in a race to the bottom for the rest. This cannot be good for the market or the consumer and seems to fail the statutory objectives on a number of fronts.

[13] As established under the Small Business Enterprise and Employment Act 2015 section 21
[14] Small Business Enterprise and Employment Act 2015 section 17

66. The principles defining a profession set out by Lord Benson in 1992[15] included responsibility for an enforcement process that would sit alongside any statutory regulatory process and operate in the interest of the public. He also noted that the standards to which the profession is beholden should be higher than that required by law. Thus the profession is seen to sign up and hold itself accountable for a set level of quality above that required by law. That translates down to the consumer as an assured level of quality and standards and provides comfort in any purchasing decision. (Interestingly Benson also required the profession to give information to the public about their experience, competence, capacity to do the work and the fees payable, principles which resonate with the recent CMA recommendations).

67. If the voluntary regulation of accountants, or the unreserved legal services performed by say a solicitor, were to be taken outside the regulatory net by separation, then it is unclear if the voluntary regulation would be supervised by the regulatory body, a new enforcement body set up by the profession, or indeed simply abandoned as an unworkable concept. A whole raft of consumer protection would be lost overnight with consequent consumer confusion as a consequence. If the professions continued with voluntary regulation, there would be duplication of effort with a doubling of oversight costs for the practitioner and probably an exit from the profession and regulatory supervision as a consequence. The LSB in this scenario would have little control over the quality of non-reserved services. This collateral damage does not seem to be addressed in the vision statement or the CMA report.

Accountability

68. In all the discussions around separation and single regulator, we have not seen a satisfactory answer to the area of accountability of the regulatory body itself. Under the current arrangements, difficult though they might be, the ARs do have accountability both to the LSB and to the member bodies. There is also accountability to the Legal Ombudsman and the Legal Services Consumer Panel. The tension allows members to have some say in the framework and the levels of fees being charged of them. If the regulatory arm is made independent of the representative arm there is no mechanism currently in place to challenge the effectiveness and monitor the efficiency of the regulatory body save the LSB, and they have no means of challenging the fees applied to them.

69. It may be that some form of body is then set up to provide that accountability, but that would be duplicating something that is effectively already in place and in some ways would then still be moving the problem rather than resolving it. A tighter governance model that assures the independence of the regulator but at the same time allows the profession a voice and challenge is something that would be far more effective.

70. One area that has not been considered either by the LSB or the CMA is the shape of the governance and the role of lay members in providing the necessary checks and balances. The Kelly regulatory governance review of ICAEW recommended greater lay input to encourage both public perception of independence and to apply diversity in the committees and board room. The FRC has recently reissued its code for audit firms on their governance emphasising the importance of non-executives in reinforcing the public interest[16] and some parallels would appear to be appropriate here in the shape of governance of the ARs. We believe accountability thorough transparent committees and boards that are not exclusively populated by members of the professions is a more effective way of achieving the outcomes sought than a simple separation.

[15] House of Lords, 8 July 1992
[16] FRC Audit Firm Governance Code July 2016 part C

71. A further issue that has not been overtly considered is the role of ARs in servicing other areas of regulation outside legal services. A number of the ARs are registered with the Financial Conduct Authority for the licensing of financial service advice, and until recently the SRA was also licensing insolvency practitioners. ICAEW, for its part, answers to six oversight bodies in the UK and internationally for the regulation of different aspects of professional services. These fall within the sphere of other ministries – for example BEIS, Treasury and the Department for Communities and Local Government. International regulatory services are discharged for the governments of Ireland and Australia in the areas of audit and tax. This is not just an issue for ICAEW but for the notaries where there are similar international obligations. These oversight bodies have different views on how regulation should be applied and, in the case of ICAEW, have relied on the existing structure with its professional member arm underpinning the regulatory performance. Changes such as separation of these functions could be in conflict with how those parts of government expect ICAEW to function as their regulator.

72. The number of firms ICAEW has licensed for probate (currently 246) is relatively small for ICAEW compared with the number of firms it licenses for PA and money laundering (13,000) and audit (3,000). Given the potential disruption to its regulatory structure that separation would cause, serious consideration would need to be given by ICAEW to withdrawing from the role of a legal service regulator were this proposal pursued. Given that ICAEW account for probably over half of the multi-disciplinary practices licensed as ABSs to date under the Act, it would seem to be a paradoxical move when the lack of ABS development has been put forward as a reason for separation in the first place. We also consider this would be a retrograde step in the natural evolution of professional services in the UK which would be overtaken by overseas competitors and damage both legal service and accountancy competitiveness abroad.

Conclusion

73. We have set out in some detail the benefits we see from the existing close relationship between regulator and representative body. We do not think these should be overlooked in any proposals to separate those functions; rather any solution be looking to provide solutions for the difficulties outlined without surrendering the benefits, and that requires a consideration of the necessary outcomes at a high level rather than a tactical one. We believe the LSB itself is well-placed to address those through its IGRs under section 30 of the Act.

74. We also question the attempt to deal with this single issue in isolation from the rest of the issues associated with the act. The regulators in the Vara letter set out a series of recommendations for different aspects of the regulatory structure which were inter-linked with each other and offered potential resolution to conflicting issues. Tackling separation in isolation creates collateral damage in the existing framework which in the short term could cause significant inefficiencies and disruption to the market; a more holistic measured approach as was suggested by Michael Gove in July 2015[17] would in our view be a better way of approaching this.

Consumer representation

75. Whilst ICAEW hitherto has not had significant engagement with the consumers of accountancy and latterly legal services, it has through its members in industry had feedback mechanisms to help shape the direction of policy and the effectiveness of the audit and accountancy provision. Accordingly we approach this particular aspect with a degree of objectivity and practicality.

[17] Evidence to the Justice Select Committee 14 July 2015 reiterated in letter to the committee on 18 November 2015.

76. We find the LSB Vision document to have some interesting discourse on this topic, but no firm direction of travel. Something we find missing in the discussion is the definition of what the consumer is. In our view this includes any purchaser of legal services, be it individual, small business or major industry and extends to overseas as well as UK buyers. Unfortunately, the discourse seems to be focused almost exclusively on the vulnerable consumer and the uninformed, rather than also taking into account the effectiveness of the current supply to current customers. Whilst unmet demand is itself an important challenge, it should not be solely focused upon to the neglect of the rest of the functioning market.

77. We noted and agreed with the representation made in the Vara letter that English law as a governing law of choice in cross-border transactions plays a significant economic role in UK[18] plc, a role that has become more important with the emergence of Brexit. Failure to consider the outside market as part of the consumer that should be represented is in our view a serious omission. The international reputation of the legal services supply is also vulnerable to adverse publicity that could be generated by services supplied to the large conglomerates, such as through faulty acquisitions advice or tax schemes that gain international notoriety.

The structure of the regulator

78. The LSB in their vision document have indicated that a single regulator should be the ultimate long term solution for the effective regulation of the legal services market. In paragraph 99, a series of outcomes are set out which they conclude would be most effectively secured through the single regulator model. However there is no exploration in their document of alternatives, or of the disadvantages that such a regulatory system would bring.

79. In its vision paper, we believe that the LSB is selling itself short as an oversight body and has failed to explore the value a fully effective oversight body such as themselves would bring. Many of the outcomes listed could be achieved by the LSB itself setting core standards and introducing consistent approaches and processes, and then monitoring the ARs to ensure they adhere to the standards and processes in discharging their duties. That this is not happening at the moment is due to the limited powers afforded the LSB by the Act and weakened influence caused by them acknowledging a limited lifespan.

80. Insufficient recognition has been made of other regulatory models including those for Audit and Insolvency where the multiple regulator is seen as a strength rather than weakness in the regulatory process. Although we have challenging discourse with the FRC in the conduct of audit, we find that the model works in terms of the tension between oversight and regulator and fellow regulator raising standards and keeping each other on their toes as a two-way accountability.

81. In the case of audit, the relevant Government department (BEIS) has devolved a substantial part of the decision making to the FRC. DCLG has followed this with Local Audit. This has allowed these ministries and parliament to stand clear of day to day discussions and to only intervene at major stress points. Whilst some checks and balances are still required, the current legal service process could be viewed as extensively over-engineered in order to allow an oversight body to emerge. Now that the LSB has established its credibility it may be appropriate to change the balance of controls around its governance and to strengthen its expertise.

[18] Ibid paragraph 4.4(1)

82. In the paragraphs above on independence we have referred to the need for regulators to be alive to the needs of the supplier as well as the consumer, and that includes specialist expertise. The observation by both the LSB and the CMA that multiple regulators may be distorting the market seems to suggest that a monopoly is a better solution. This seems to us a paradoxical position for the CMA and fails to consider the deeper reasons why such multiple regulators exist and are used in other regulated areas. The specialisms of the patent attorneys and notaries for example are part and parcel of the quality assurance of the market that assures the consumer of the expertise of the supplier in niche areas of law and provides the breadth of choice. A one size fits all regulator would damage quality, reduce choice and inhibit competition.

83. Indeed the entry of the new bodies into the market has resulted in the SRA and the BSB having to look again at their regulatory frameworks as they are now starting to be disadvantaged by their peers. We have noted for example that those licensed by ICAEW to carry out probate are losing their AI status when moving to the SRA for licensing as the SRA are not applying rules of equivalence but rather setting higher entry requirements. This signifies an imbalance which market forces will quickly unravel to the benefit of the consumer – but not if there is a single regulator.

84. A single regulator is not always a successful model, as the mixed past of the late Financial Services Authority has illustrated. There needs to be clear governance, accountability and flexibility which the proposals do not in our view fully address. There would be a danger that this behemoth would be accountable to no one, that complacency would creep in, and that the Ministry of Justice would need to step in at regular intervals to keep the animal in check. This would be akin to government interference in the judicial oversight process, something which both the LSB and CMA are keen to avoid, and we concur with their view. There would also be cost management issue and budgets which would be difficult to oversee, and a danger that there would be wholesale exits from the practitioner market under its oversight making the cost model unsustainable.

85. In short we consider the single regulator model inappropriate to this market at a time of significant change being brought by automation of services and economic uncertainty linked to Brexit. The multiple regulator model brings with it innovation hubs of best regulatory practice which an oversight body can then leverage and apply across the sector. A single regulator would not foster such agility and risk stagnation.