

SRA response

The Legal Services Board consultation on reviewing Internal Governance Rules

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Introduction

- 1. This response is submitted on behalf of the Solicitors Regulation Authority (SRA).
- 2. The SRA is the regulator of solicitors and law firms in England and Wales. We protect consumers and support the rule of law and the administration of justice. We do this by overseeing all education and training requirements necessary to practise as a solicitor, licensing individuals and firms to practise, setting the standards of the profession and regulating and enforcing compliance against these standards.

Summary

- 3. We welcome the Legal Services Board (LSB) review of the Internal Governance Rules (IGRs). As the consultation document says, the current arrangements have generated “a steady stream of disagreements about independence”. The review is timely as it has always been clear that the regulation of legal services would evolve and develop in the light of experience.
- 4. On 26 October 2017, the Law Society Council agreed reforms to the General Regulations that increase the extent to which the SRA Board can act independently in the public interest, while remaining within the overarching Law Society Group structure.
- 5. This is a positive step forward in the development of the regulation of solicitors, which we welcome.
- 6. This consultation is an opportunity to take further significant steps to maximise regulatory independence within the current framework in the public interest.
- 7. As both the LSB and the Government in its response to the CMA report and in its tailored review of the LSB, have made clear, regulatory independence is a key principle and a matter of public confidence.
- 8. It is in the public interest to do everything possible to secure that independence, particularly at a time when the constitutional uncertainty around Brexit requires public confidence in the justice system and the legal profession. Research shows that the public will place more trust in solicitors if their regulation is independent. That trust has never been more important.
- 9. The longer-term ambition must be stand alone, independent regulation with clear lines of accountability to the public we serve. This could be through the scrutiny of a select committee, or perhaps oversight by the judiciary.
- 10. We do however recognise the current constraints and see the fullest possible independence within the existing framework as the next step on the journey.
- 11. The LSB has presented two options for change, with the second option presented as three incremental versions of IGR reform.
- 12. We support **option 2c** – the development of a new IGR framework. We support the concept of gateways, greater transparency and a move to assurance.
- 13. Our independence is key to our ability, and that of solicitors, to secure public confidence. We are clear that the best way to demonstrate this independence within the current framework is to build on the progress made – as set out in paragraph 4 – to establish the SRA as a separate legal entity within the wider Law Society Group.
- 14. Such a separate entity would have complete separation in terms of governance, operations and resources, including a separate balance sheet and financial reporting mechanism. This would allow us to deliver our functions efficiently and cost-effectively. We would also be able to show, for the first time, real transparency on the cost of regulation for solicitors and the public.
- 15. In addition to urging the LSB to use its powers to maximise independence in this way, we would also welcome timely progress. Effective regulation is clearly a matter of public interest and we know that eight out of ten people prefer independent regulation. There can be no reason to delay the use of all the LSB’s powers to maximise independence.

Questions 1 and 2

- 16. It is a matter of public record that we have been concerned that the arrangements set out in the Law Society’s General Regulations, which establish our powers and provide the governance framework for the way in which we operate as a Board of the Law Society Council, did not comply with the current IGRs. This is because in places they did not meet the requirements and expectations of the rules. Overall, they did not provide a transparent and proportionate mechanism for oversight.
- 17. The LSB started a formal investigation in February 2017, into whether there are any causes for concern in this area. Our submissions to that investigation provide our response to questions one and two of this consultation and do not need duplication here.
- 18. We welcome the October 2017 decision by the Law Society Council to reform the General Regulations. This increases the extent to which the SRA Board can act independently in the public interest, while remaining within the overarching Law Society Group structure.
- 19. While we welcome this progress, we know more needs to be done to meet the public expectation that regulation should be independent.
- 20. Prior to the Legal Services Act, the Law Society looked at a range of models for separate regulation. One option was to establish a regulator as a separate legal entity within the Law Society Group. Ten years

later it looks like a simple, effective and attractive option.

- 21. We have carried out some early feasibility work on establishing a separate legal entity. The indications are that transition would be straightforward and cost effective.

Questions 3 -14

- 22. We disagree with the no change option, for the reasons set out above and at paragraphs 30-38 below. We do not support options 2a and 2b.
- 23. After seven years' experience of the current IGRs, we believe real reform is required to deliver regulation that the public can trust and place its confidence in. That means maximising the independence possible within the current framework.
- 24. Options 2a and 2b do not go far enough. Any potential benefit would be outweighed by the opportunity costs of transition serving as a distraction at a time when the regulators are pursuing sector reform and responding positively to the CMA review.

Questions 15 to 25

- 25. We support **option 2c** – the development of a new IGR framework, the concept of gateways, greater transparency and a move to assurance.
- 26. Our independence is key to our ability to act objectively in the public interest and to secure public confidence. The best way to realise this public benefit and achieve independence within the current framework is for us as the regulator to be established as a separate legal entity within the wider Law Society Group.
- 27. Such a separate entity model would ensure a complete separation of governance, operations and resources, including a separate balance sheet and financial reporting mechanism. This would provide us with greater control, and therefore the ability to deliver our functions efficiently and cost-effectively.
- 28. Importantly, we would be able to provide the public and the profession with clear reporting on the cost of regulation, something the current arrangement does not allow. As a separate entity with separate financial reporting we would be fully transparent about the detail of our costs.
- 29. We provide more detail of our reasoning and recommendations in the table below. More detail is added in the subsequent paragraphs. This is based on our view that option 2c would require a full rewrite of the IGRs.

Summary of recommendations

Recommendation	Summary
To play a greater role in maximising and safeguarding independence	• The Government recognised the need for the LSB to do more to maximise independence within the current framework^{1 [n1]}. • The LSB should address this issue expressly as its primary priority, by redrafting the IGRs to support the maximum regulatory independence possible within the current legislation. • The IGRs should therefore support the creation of a separate legal entity for the SRA, allowing us to establish our own balance sheet and creating greater transparency on the costs of regulation. • The LSB should use its periodic performance reviews to ensure the independence of regulatory functions.
To revise the definition of regulatory independence	• The current definition is narrow and uses negative terms. • This is an opportunity to define independence positively, in terms of the freedom to operate autonomously and without influence or control.
To set out the approved regulator assurance role	• Once an approved regulator delegates regulatory functions to an independent body, it should have no residual involvement in or oversight of those functions. • The LSB should clarify this in the IGRs, making it clear that the approved regulator's role is "assurance" rather than oversight.
To revise the style and format of the IGRs	• The current rules are hard to navigate, and open to interpretation. • Drafting should be revisited to provide greater clarity and detail, for example specifying separate balance sheets.

Safeguarding independence

- 30. We recommend that the LSB plays a greater role in maximising and safeguarding independent regulation in the public interest. We agree with the consultation document that regulation should ideally be structurally, legally and culturally independent of the professions and government. This is important in giving confidence to consumers, providers and investors, as well as wider society.
- 31. This view has been reinforced in a number of reviews and publications, including the recommendation of the Competition and Markets Authority (CMA) in its 2016 report^{2 [n2]}. This was supported in June 2017 by Which?, the consumer body, in its "consumer agenda for the next government"^{3 [n3]}.



- 32. In its December 2017 response to the CMA report, the Government recognised the importance of a robust regulatory regime, along with the need for the LSB to do more to maximise independence within the current framework⁴.
- 33. The Treasury made a commitment in 2015 to consulting on regulatory independence in the legal sector⁵. It further reinforced its position in the 2017 Budget, stating in para 4.36 that “Independent regulators make sure markets for essential services, like energy and water, work fairly and efficiently”⁶.
- 34. Independent polling shows that eight out of ten members of the public want solicitor regulation to be independent of the profession, with seven out of ten saying that they would trust solicitors more if this were the case⁷. This becomes increasingly important as we work to increase access to justice, helping to make legal services available to people from all communities.
- 35. This is about public confidence. Independent regulation would boost public confidence in the way we work in the public interest. It would provide clarity on who is accountable and responsible, addressing the confusion that the existing complex arrangement inevitably produces.
- 36. At present, we simultaneously must act independently of the Law Society, while remaining constitutionally part of the same organisation. This is out of step with what the public recognises as independent regulation in other sectors. In the medical, utilities and banking sectors a clear distinction exists between regulator and representative body. The evidence shows that there is clear perception problem with this lack of independence in the legal sector. The public does not trust regulators that are closely linked to representative bodies.
- 37. Independent regulation is also good for the profession. It will help remove unnecessary constraints on legal services, supporting an open, innovative and competitive sector that not only offers the public affordable and accessible legal services, but importantly, provides opportunities for solicitors and law firms of the future.
- 38. As the Ministry of Justice highlights in its tailored review, safeguarding independence is one of the LSB’s key statutory roles⁸. We believe it should address this issue expressly and as its primary priority within the IGRs. Establishing the SRA as a separate legal entity within the wider Law Society Group would be the best way of safeguarding our independence within the current framework.
- 39. In answer to questions 21 to 25, we think that the LSB should safeguard independence through its regulatory performance assessments. This would provide an opportunity for it to periodically review the arrangements and whether they are working to ensure independent regulation.
- 40. We believe this is more effective than relying on self-certification. It would provide the LSB with evidence of good practice, and areas for improvement. The latter could then be initially addressed informally.
- 41. As a separate legal entity, we would be able to provide third party assurance in the form of financial and audit reports.

Definition of regulatory independence

- 42. We recommend that the definition of regulatory independence should be revisited. This is currently narrow and described in negative terms, essentially providing that those with representative functions must not have undue influence or control over the performance of regulatory functions.
- 43. This review presents an opportunity to define independence more positively, in terms of the freedom to operate autonomously and without influence or control. This would be the case if we were a separate legal entity within the Law Society Group.
- 44. Whilst we agree with the LSB that it is not able to require full structural or legal separation, it could do more, through its IGRs, to present this as best practice. For example, through indicative arrangements, or when describing the key factors that must be present in any governance arrangements.
- 45. To provide a further example, rule 7 and other requirements should in our view be replaced by more categorical statements to ensure that the exercise of regulatory functions is independent and separate from representative functions and that the regulatory board or other entity has autonomy and control over the financial and other resources it requires. This is instead of describing it in terms of access to resources held by the approved regulator. This could be underpinned by a new, more positive definition of independence.

The approved regulator assurance role

- 46. We recommend that the nature of “oversight” by the approved regulator should be clarified. As the body charged with statutory responsibility for the regulatory functions, the approved regulator remains accountable in law for the exercise of those functions. However, once delegated to an independent board or body, it should have no residual functions or indeed “oversight” of the performance of those functions and it should not duplicate the role of the LSB in overseeing regulatory performance.
- 47. Changes could usefully be made to clarify this position and to establish what is more properly termed, in our view, the approved regulator’s “assurance” role – namely to ensure that the regulatory board remains a safe vehicle for the regulatory functions.
- 48. This should be limited, as set out in the new General Regulations, to the ability to take action where there has been a manifest and fundamental failure to properly exercise the delegated regulatory functions (following, and as evidenced by, LSB enforcement action) or to govern itself and its finances in a sound and robust manner.
- 49. This could be reinforced in the rules by clarity around the information “gateways” through which such assurance is obtained. We do not have a detailed view on questions 15 to 19, but support the principle of

gateways. We would envisage some form of annual reporting, with exception reporting when specific criteria were met.

Style and format

- 50. We recommend that the style and format of the rules be revisited. The current rules are hard to navigate, and open to interpretation. While we would not wish to recommend an inflexible, prescriptive approach, we consider that the drafting could be revisited to remove the complexity created by the separate table of principles, rules and guidance and to provide greater clarity and detail around the key requirements.
- 51. As an example, the current rules on appointments are circular in places, (see Part 2(C)), and arguably maintain the position that appointments are ultimately made by the approved regulator, who retain a key role in the process (guidance to 2(B)). The rules could make it clear that appointment, reappointment and removal decisions, as well as processes, are for the regulatory body to exercise, without influence or involvement from the approved regulator.
- 52. In a further example, in line with maximising independence, instead of stating that the regulatory body “must have power to do anything within its allocated budget...”, the rules could make it clear that separate balance sheets are best practice to allow full control over financial and other resources, and provide for minimum safeguards should this not be the case.

Conclusion

- 53. It is in the public interest that the LSB makes it a priority to use all its powers to maximise and safeguard the independence of regulation within the current framework.
- 54. That can be best achieved by establishing the SRA as a separate legal entity within the Law Society Group. This arrangement will enhance public confidence in regulation and legal services and allow for transparent financial reporting.
- 55. A new IGR framework, with fully redrafted simple, clear rules should provide for the LSB to safeguard independence through its performance assessments. New IGRs should clarify the approved regulator assurance role and set out appropriate gateways for information sharing.
- 56. The long-term objective has to be fully independent regulation, meeting public expectations of a modern sector and profession.

Notes

1. Ministry of Justice (December 2017) https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/669507/Govt-Response-to-CMA-study.pdf (https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/669507/Govt-Response-to-CMA-study.pdf)
2. Competition and Markets Authority (December 2016) <https://www.gov.uk/cma-cases/legal-services-market-study> (<https://www.gov.uk/cma-cases/legal-services-market-study>)
3. Which? (June 2017)
4. Ministry of Justice (December 2017) https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/669507/Govt-Response-to-CMA-study.pdf (https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/669507/Govt-Response-to-CMA-study.pdf)
5. HM Treasury (November 2015) <https://www.gov.uk/government/publications/a-better-deal-boosting-competition-to-bring-down-bills-for-families-and-firms> (<https://www.gov.uk/government/publications/a-better-deal-boosting-competition-to-bring-down-bills-for-families-and-firms>)
6. HM Treasury Autumn Budget (November 2017) https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/661480/autumn_budget_2017_web.pdf (https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/661480/autumn_budget_2017_web.pdf)
7. Comres (February 2016) www.sra.org.uk/sra/news/press/independence-polling-release-2016
8. Ministry of Justice (July 2017) https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/630084/lrb-olc-tailored-review-2017.pdf (https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/630084/lrb-olc-tailored-review-2017.pdf)