Legal Services Board (LSB) Consultation: Reviewing the Internal Governance Rules

A response by
The Chartered Institute of Legal Executives (CILEx)

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Contents Page

Introduction	3
Substantive points	3
Responses to specific questions	5
Question 1	5
Question 2, 3, 4 & 5	7
Question 6	9
Question 7	9
Question 8	10
Question 9	10
Question 12	10
Question 15	11
Question 16 & 17	11
Question 18	13
Question 19	13
Question 21 & 22	13
Question 23 & 24	14
Conclusions	14

1. Introduction

1.1. The Chartered Institute of Legal Executives (CILEx) is the professional association and governing body for Chartered Legal Executive lawyers, other legal practitioners and paralegals. CILEx represents around 20,000 members, which includes approximately 7,500 fully qualified Chartered Legal Executive lawyers.

1.2. CILEx is the Approved Regulator under the Legal Service Act 2007[1]. These regulatory powers are delegated to the independent regulator CILEx Regulation Ltd.

1.3. CILEx enjoys a positive engagement with the LSB and believes that it is possible to make incremental amendments to the Internal Governance Rules (IGRs) to make them more effective.

2. Substantive points

2.1. CILEx supports the move toward enabling greater regulatory independence that the proposed changes to the IGRs facilitate. However, we believe that this needs to be underpinned with explicit links to a robust regulatory performance assessment process if the Approved Regulators (ARs)[2] are to be held properly and genuinely accountable for their actions. In this way, both consumers and the regulated community can have real confidence that there is proper oversight of how they operate. The IGRs must be clearer in (a) recognising the need for proper oversight and accountability of the activities of ARs and (b) defining the limits of oversight by both the LSB and AARs better.

2.2. Delivering this outcome will require a clear assessment of the interplay between ARs' need to meet the Regulatory Objectives, a redrafted set of IGRs and the role of the LSB's Statutory Guidance. A balanced combination of obligations and oversight derived from those elements should be able to ensure that ARs demonstrate risk-based, evidence-supported and outcome-focused regulation.

2.3. In achieving this, it will also be necessary to bear in mind that not all relationships between AARs and ARs are the same. Any redrafted IGRs will have to be general enough to manage those differing relationships, and practical arrangements that derive from them, and specific enough to add

[1] The Applicable Approved Regulator (AAR) as defined in the current Internal Governance Rules
[2] The frontline regulators to whom the conduct of actual regulatory functions is delegated, as defined in the current Internal Governance Rules.

value by clarifying any problematic scenarios that those differing relationships give rise to.

2.4. The Legal Services Act is in many ways a compromise: it did not lead to full regulatory independence; it recognised the interdependence between the AARs and the ARs. In many cases, from a financial/infrastructure support perspective, one cannot survive independently of the other. This is the reality recognised by the Act but there is a risk that lack of accountability and control could lead to an existential threat to some AARs if neither they nor the LSB hold ARs practically account for their performance, have visibility of their management of risk or have the ability to challenge plans on the basis of business plans. If the LSB's oversight and scrutiny role is to be limited, then this must be accompanied with a more robust performance assessment process. Without this, there is a real risk that ARs are effectively unaccountable to anyone; if their respective boards were to in some way err, there would be no check available.

2.5. Subjective terminology is not helpful – where this language is used in the current IGRs, it enables differences in interpretation to result. Any redrafted IGRs will have to be specific enough to ensure that the boundaries between regulatory and non-regulatory activities are clear and not open to subjective interpretation.

2.6. ARs are already, to all intents and purposes, independent in all but formal legal separation from the AARs: in CILEx's experience, regulatory activities are performed without any interference from the AAR's representative role; resources required by the regulator to undertake those activities are always made available. Whilst this must be the right way for regulatory functions to be discharged in principle, it must also be right that the ARs should be required to produce sound business plans for their activities and it must be healthy for those plans to be capable of constructive challenge and rigorous testing by the AAR to ensure they are appropriate.

2.7. Any future IGRs must also recognise, of course, that there will be times where constructive challenge and rigorous testing creates tensions and even disagreement between the AAR and AR. The consultation paper acknowledges that disputes do arise[3] but it is important to recognise that those disagreements are not always just related to interpretation of '*what residual functions remain with an AAR'* or '*what oversight the AAR should exercise over its regulatory body'*.

[3] Consultation paper, para 26

2.8. Because the context of the relationships between AARs and ARs vary, scenarios can arise where there is real uncertainty, and therefore the potential for disagreement, in relation to where regulatory boundaries lie. CILEx and CILEx Regulation are arguably one such specific case: CILEx, unlike for example the Bar Council and the Law Society, develops qualifications, has a developed and changing set of membership grades, and has a commercial training provider within its group of companies; for its part, CILEx Regulation, again unlike for example the Bar Council and the Law Society, does not have to authorise all practising members of CILEx because the majority of CILEx members are not conducting reserved legal activities. In that context, the potential for grey areas of interpretation to emerge where clarity through prescription in guidance is absent is all the greater.

2.9. Of course, CILEx recognises that it would be disproportionate to attempt to legislate for all the varying scenarios there may be in any level of prescribed detail. However, CILEx has come to the view that there is a role for the LSB to act as a mediator or arbiter in situations where an impasse may develop between an AAR and AR. In such an arrangement, revised IGRs would have to form one element of a suite of materials which would be complemented by LSB Statutory Guidance on a variety of standards[4] and a more robust performance assessment process whereby ARs have to assess themselves against those standards[5].

3. Responses to specific questions

Question 1: We welcome evidence on (i) the general nature, frequency and impact of disagreements on regulatory independence matters, and (ii) how the IGR are used and their effectiveness in moderating such disagreements.

3.1. CILEx recognises many of the problematic issues highlighted in the consultation paper[6] that relate to the current IGRs. CILEx's own experience is that, in general, there are infrequent disagreements on regulatory independence matters between it and CILEx Regulation. This is mainly because both organisations have taken a pragmatic approach to ensuring the relationship is functional: A Protocol between the 2 organisations is in place, supported by Service Level Agreements relating to the provision of 'back office support'[7].

[4] Such as Education and training, Governance, Finance, Risk management.
[5] In a process not similar to that managed by
[6] Paras 26-32
[7] Both currently undergoing joint collaborative revision with a view to enhancement as part of CILEx's ongoing Governance Review.

3.2. However, it is true to say that the IGRs have not been particularly tested in the context of this relationship. It is also true to say that when the IGRs have been referred to for guidance, for example in relation to the provision of resources or in-year bids for further budget, they have been found lacking: Firstly, this relates to the use of subjective language in the IGRs; phrases such as '*to make available such resources as are reasonably required and appropriate to enable the frontline regulator to carry out its regulatory functions*' are unhelpful. In the absence of any requirement for budgets or bids for additional funds to be accompanied by a business plan, it is only the frontline regulator that is permitted to make that judgment.

3.3. The AAR therefore has to take on trust that the resources are required and the business case sound. In CILEx's case[8], the frontline regulator does not even permit sight of their Risk Register; this leads to the situation where the AAR must bear all the risk for activities without any control (or clear idea of those controls it might have or where else they might lie if not with it) or ability to challenge. In the worst-case scenario, this would enable the AR to make a decision or undertake an activity that, if it went wrong, could pose an existential threat to the AAR (and ironically, by extension, to itself).

3.4. Whilst CILEx supports the conclusion that making any regulation too prescriptive can create a burden, the IGRs must be specific enough to bring clarity to specific scenarios where, perhaps for some AAR/AR relationships more than others, the regulatory/non-regulatory boundaries are less clear: for example, for CILEx, there could be greater clarity beyond what is both in the Legal Services Act and LSB guidance[9] in relation to education activities. Whilst we can see that setting of standards, quality assurance and granting of authorised person status are clearly regulatory functions, it is not so clear in relation to conducting assessments against standards, award of qualifications etc.

3.5. This is also a good example of where the IGRs are not sensitive enough to allow for the varying contexts of the relationships between AARs and ARs: CILEx is a membership body and an Ofqual Awarding Body offering membership grades (as distinct from any regulatory status) and developing and awarding qualifications (pathways which may lead ultimately to the attainment of authorised person status). In other sectors, the model used is one in which assessment is undertaken by the professional association, but quality assured by the frontline regulator. As with resources above[10] though, the IGRs mean that it is only the frontline regulator who can make this

[8] Possibly also in the experience of other AARs

[9] 'Guidance on regulatory arrangements for education and training issued under section 162 of the Legal Services Act 2007'; March 2014

[10] Para 3.2

judgment; there is no objective 'right answer'.

3.6. CILEx's conclusion is, therefore, that the IGRs are best for a relatively superficial steer on the boundaries between regulatory and non-regulatory functions, but they cannot cope with specific scenarios where there is a lack of clarity because (a) they do not allow for the varying contexts which inform different AAR/AR relationships and (b) they are not clear or objective enough to inform and clarify any specific problems of interpretation which may occur.

Question 2 - What are the benefits and costs to stakeholders of operating under the existing IGR framework?
and
Question 3 Do you agree with option 1: no change to the IGR? Why or why not?
and
Question 4: What information do AARs need to receive from their regulatory body, and why? To what extent can these needs be met through transparency (and vice versa), thereby removing the need for further engagement?
and
Question 5: Do you want more intervention by the LSB in disputes between AARs and regulatory bodies? If so, what form should this intervention take?

3.5 As stated above, the IGRs provide a good general indication of the boundaries between regulatory and non-regulatory functions. However, though it is difficult to quantify in costs terms, time is taken in relation to discussing and resolving some issues where those boundaries are less clear.

3.6 CILEx appreciates that it could be difficult for the LSB to assume an enhanced role to intervene in these matters. The need to be that arbiter (except as a last resort) in the future could, however, be lessened by clearer IGRs. It is important to consider here what the ultimate outcome of the IGRs (and for that matter the LSB itself) actually is. CILEx is of the view that that outcome should be to achieve better, effective regulation in the public interest[11].

3.7 That being so, CILEx struggles with the suggested exploration in the paper '*to reduce unnecessary duplication of the LSB's oversight role…'.* As stated above, CILEx is of the view that oversight, in the sense of truly holding ARs to account or being able to challenge their plans or conclusions, is not actually exercised by anyone in the current regulatory arrangements. For that reason, CILEx is not in favour of Option 1 (no change to the IGRs). Amended IGRs would do well to at least be clearer on the limits and reality of the oversight role of both the LSB and the AARs.

[11] I.e. not just to ensure that the regulation is independent but right.

3.8 CILEx also does not accept[12] that reducing the need for '*interaction between the AARs and regulatory bodies'* might achieve the outcome of effective regulation. Such a move would simply ensure that any notion of oversight of any consequence (i.e. that would make any practical difference to the plans of the AR) would be removed from AARs. This could expose them to greater organisational risk themselves and create a further risk that no-one is able to prevent 'bad regulation[13]', the negative consequences of which would be borne ultimately by consumers.

3.9 This links to the question of information provided to AARs by ARs, though provision of information is inextricably bound up in the issue of effective oversight: in CILEx's case, the level of information the AAR requires is the same level of information that it requires of all other companies in the CILEx Group[14]. Although CILEx acknowledges and supports the fact that regulation, as a delegated function, should operate independently from any interference from any other part of the Group, CILEx wishes, just as it does for all its component parts, to ensure that the operation of its regulator is proportionate, responsible and effective so as not to adversely affect the overall health of the CILEx Group as a whole.

3.10 Having transparency goes some way to meeting these needs but, as stated above[15], being aware <u>without</u> any effective levers or means to challenge plans (be it by CILEx or the LSB) is at best pointless and at worst exposes the AARs to all the risks when having no means to mitigate them. Ultimately, in an AAR/AR relationship in which the organisations are mutually reliant on one another, having sight of regulatory risk registers is key because should a risk come to fruition which existentially threatens the Group, all companies, including the AR, would suffer.

3.11 CILEx sees a role for the LSB to be an arbiter or mediator on matters where there is some lack of clarity on interpreting the IGRs (or even, at its most extreme, a related dispute). However, this should be complemented with amended, clearer IGRs which should reduce the need for ever greater resources to be deployed by the LSB or necessitating any additional levy on the profession to cover those costs[16].

[12] As seems to be implied in para 45 of the consultation paper
[13] Until after the event.
[14] I.e. sight of Strategy and Business Plans, budget and accounts, risk registers etc.
[15] Paras 3.3 and 3.8
[16] Consultation paper para 49

Question 6: Do you agree with option 2a: making incremental changes to the IGR? Why or why not?

3.12 CILEx agrees that it may be possible to improve the current IGRs either by incremental change or by a new approach altogether. CILEx can see the appeal in focusing a revised set of IGRs around the 4 principles relating to governance, appointments, strategy and, resources and oversight. However, consistent with what has been said elsewhere in this response, CILEx would caution against being too limited or general in this approach.

Question 7: What incremental changes should the LSB prioritise, and why?

3.13 The types of incremental change CILEx suggests would:

i. Give greater definition to the role of AAR oversight:

This might be to permit scrutiny and challenge of documents which assure the AAR of the efficient and effective running of the regulatory operation, such that it enables acquisition of an assurance that it does not pose a threat to the health (existential or otherwise) of the AAR;

ii. Introduce a specific requirement for the AR to support any activities in its business plan or new initiatives with the production of a business case, supporting evidence and risk assessment, and for this to be shared with AAR;

iii. Greater definition of the oversight role of the LSB:

Giving clarity over the AARs/ARs ability to refer issues to the LSB and the extent to which the LSB looks behind the 'process' of regulation, or regulatory change, to the intended outcome of those regulatory plans/changes.

iv. Greater definition of the LSB's role to act as a mediator or arbiter/definitive decision-maker on IGR/regulatory matters.

As already stated[17], greater clarity within a suite of complementary materials should mean that this role would be kept at a minimum (and not require an ongoing injection of resources). However, this would also require a degree of formality about it, such as inclusion of appropriate references to the role and its parameters within the revised IGRs so that all AARs and ARs understood how such a role

[17] E.g. para 2.9 above

would work and what its limitations are[18].

Question 8: What do you anticipate the impact of your proposed change(s) would be, and why?

3.14 CILEx anticipates that better drafted IGRs would reduce the need for time to be expended debating their interpretation at AAR/AR level and reduce the need for the LSB to intervene or arbitrate between them. This might in turn enable a clearer role for the LSB to have to occasionally assume the role as mediator or arbiter on such rare occasions.

Question 9: Do you agree with option 2b: making more extensive changes to the IGR? Why or why not?

3.15 CILEx does not agree with option 2b i.e. making more extensive changes to the IGRs. This is because we believe that if the IGRs are not capable of being improved by relatively minor incremental change, it would be better to consider a new approach entirely.

Question 12: Do you agree that the definition of AAR should be revised? Why or why not? If so, how do you think the definition should be revised, and why?

3.16 CILEx supports reconsideration of the AAR definition as part of incremental change to the IGRs. It makes sense that the IGRs should be capable of being 'tracked back' to the Legal Services Act. By creating the principle of and then naming Approved Regulators, the Act recognised that a relationship between the ARs and the frontline regulators, to whom regulatory functions were delegated, would continue to exist even when the new arrangements to ensure independent regulation were in place. Introducing a term (AAR), which is not in the Act itself, begins the process of blurring the lines and reducing the clarity of the regulatory arrangements in place.

3.17 In relation to the definition of 'regulatory independence'[19], CILEx does not regard it as narrow; it is simply too general and open to subjective interpretation. Consistent with what has been said above[20], the IGRs would benefit from some greater definition (i.e. qualification of what is in the Act) of what constitute 'regulatory functions'. As also said above, as currently drafted the IGRs permit the frontline regulators themselves to define what a regulatory function is; if the LSB is to have any specified oversight role, key to it must be to ensure consistent and objective definition of what is or is not a regulatory

[18] I.e. reducing random contact with the LSB to resolve an impasse by greater clarity of the LSB's formal role to make a difference in such circumstances.
[19] Consultation papa 70
[20] E.g. para 3.5

function. There has to be some objective definition to give all parties certainty; there is no certainty if a regulatory function is simply a regulatory function because the frontline regulator says it is.

Question 15: Do you agree with option 2c: a new 'gateways' approach to the IGR? Why, or why not?

3.18 As stated above, if it is not possible to achieve greater clarity through a minor amendment of the current IGRs, then CILEx would favour a new approach to pick up and deal with the issues highlighted above. We agree that sharing information has a role to play in this and risk management and performance information are particularly important: mere sight of that information cannot be deemed as inappropriate interference in regulatory matters (though in some quarters it is regarded as such).

3.19 Provision of information will be particularly important when the AR seeks in-year unbudgeted funds in order, for example, to have to respond to a regulatory/environmental issue that unexpectedly arises. In such an instance, a business case and risk and impact assessments should have to be supplied. This again highlights the fact that not all AARs have the same relationship with their ARs: in the case of CILEx[21], CILEx Regulation is not as financially independent of CILEx, even with the Practising Certificate Fee income, as other ARs are of their AARs; if CILEx is required to provide any degree of subsidy, then it is only proportionate to expect a proper supporting business case to be provided.

Question 16: What gateways (i.e. permissible channels for information and assurance to flow between regulatory bodies and their AARs in the normal course of events) do you think would be needed, and why?
and
Question 17: Do you think independent standards or benchmarks could be used to indicate when AARs are able to seek additional assurance? If so, what are these, and why?

3.20 Specifying a series of gateways might be a way of specifying the type of information to be shared between AARs and ARs. Finance, governance and regulatory performance information are initial appropriate areas but CILEx also believes that, if this approach is taken, 'risk' should be specifically included, as should the need to provide a supporting business case in appropriate circumstances.

[21] As opposed to, for example, the relationship between the Law Society and SRAS and Bar Council and Bar Standards Board

3.21 It is not clear to CILEx that this would result in '*a reduction in the AAR's discretion to oversee its regulatory body*'[22] as, with the present lack of clarity over what that oversight looks like now, it is CILEx's view that no meaningful oversight actually takes place at present and attempts to do so can be rebuffed by the AR having the discretion to decide what is deemed 'regulatory' and therefore out of reach.

3.22 If provision of this information indicated to the AAR that '*problems were developing'*, CILEx would expect an incremental approach to be taken i.e. in the first instance, those concerns would be 'sense checked' with the LSB and, if valid, the LSB would have the discretion to make further enquiries. This is because such scenarios are likely to arise on a <u>per issue basis</u> rather than necessarily through a prolonged pattern of behaviour that immediately necessitates the contemplation of the LSB replacing the regulatory board[23].

3.23 The example of gateway financial information provided in the consultation paper[24] seems sensible but should include how reactive matters are handled as well as those that could be reasonably planned for. Therefore, the addition of a paragraph of what information would be required in the event of unforeseen in-year expenses being required should be included. This could be an example of an area which would benefit from the application of an independent benchmark trigger for the AAR to seek additional assurance. A similar benchmark at the opposite end of this particular scale might be in relation to a scenario in which the AR consistently underspends against budget: not only in such a circumstance are resources potentially tied up and unavailable for alternative use, this might also be an indicator of poor financial planning or unrealistic target-setting.

3.24 As with the current IGRs, the real test does not relate to 'the usual run of business'; it is at those times when something unforeseen or novel occurs. The efficacy of any new IGRs should be judged against how they handle those scenarios and not steady state business as usual.

3.24 Furthermore, CILEx senses that the inference of these proposals is that, if the need for interaction between the AARs and ARs can be reduced to a finite set of circumstances/occasions, then this will itself reduce tensions or the need for as many AR or LSB resources to be expended. Whilst this undoubtedly could be the case, CILEx believes that ongoing relationships and dialogue between AARs and ARs is a positive factor and should not be lost in the event that option 2c is carried forward. Mutual shared understanding is built upon exposure to ideas, motivations and aspirations, and to lose that in favour of a

[22] Consultation paper, para 75
[23] As seems to be contemplated in the same para 75.
[24] Para 76

few specified instants would be to the detriment of the functioning of both AAR and AR roles and ultimately standards of regulation could be all the poorer for it.

Question 18: What action do you think an AAR should be entitled to take when seeking additional assurance in the circumstances described above, and why?

3.25 In such circumstance, AARs should have a range of (perhaps escalating) options to take which might include:

i. A request for further clarificatory information;
ii. A right to make representations to the regulatory board;
iii. Discussion with the LSB;
iv. Referral of the matter to the LSB.

Question 19: What do you anticipate the impact of and risks associated with the 'gateways' approach would be, and why?

3.26 CILEx recognises that, subject to working up the degree of detail required, a gateway approach does have positive merits. However, as with the current IGRs, care will have to be taken that the gateways set are not too general or rigid in their application to be of use in the various potential scenarios that could occur in practice.

Question 21: Do you agree with reintroduction of DSC to assure compliance with the IGR? If so, what form should this take and why? What do you anticipate the impact of DSC would be, and why?
and
Question 22: Do you agree with IGR compliance becoming part of regulatory performance assessments? If so, why? What do you anticipate would be the impact of IGR compliance becoming part of regulatory performance assessments, and why?

3.27 CILEx does not favour the reintroduction of dual self-certification (DSC). As was demonstrated at the time, we believe that it is too far removed from practical realities to have any real impact upon potential areas of disagreement in relation to how the IGRs should be applied. CILEx prefers the proposal that such assurance should be incorporated within the LSB's regulatory performance assessment process. We believe that assurance is fundamentally bound up in performance review and this proposal gives the opportunity to make it one seamless integrated process with a more proportionate impact on participants than a requirement to undertake 2 separate processes.

Question 23: Do you agree with the existing option for proactive reporting of non-compliance? If so, why? What do you anticipate the impact of this would be, and why?
and
Question 24: Do you agree with third party assurance? If so, why? What do you anticipate the impact of this would be, and why?

3.28 On balance CILEx supports the retention of the existing option for proactive reporting of non-compliance rather than third party assurance. Neither option is perfect, for the reasons identified in the consultation paper, but the former seems to CILEx to be the more proportionate approach to take. Use of a third party has greater capacity to burgeon into a more bureaucratic burden than retaining it as part of existing option.

4. Conclusions

4.1. CILEx supports the revision of the IGRs and the greater degree of regulatory independence that this may facilitate. However, we believe that this must be combined with an improved regulatory performance assessment process, a revision of, or greater specificity of, the LSB's future role as a mediator or arbiter and redrafted complementary statutory guidance.

4.2. Such changes should recognise and enable the management of the varying relationships and dependencies that exist between AARs and ARs.

4.3. Future requirements should be general and not overly prescriptive but detailed enough to require the maintenance and visibility of risk and regulatory impact assessments and the provision of evidence and supporting business cases where appropriate.

4.4. If one of the ultimate objectives of these changes is to improve and maintain better regulation, reducing the points of AAR/AR interaction will not itself be sufficient; real, specific changes, as described above in this response, are required in order to achieve right regulation and give both the regulated community and consumers the confidence that this is the case.

For further details

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