

To:	Board
Date of Meeting:	27 November 2013
Item:	Paper (13) 81

Title:	Application from the Chartered Institute of Legal Executives/ILEX Professional Services Limited seeking a recommendation to the Lord Chancellor that for designation as an approved regulator for reserved instrument activities and probate activities
Workstream(s):	Statutory Decisions
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Status:	Unclassified / Protect / Restricted

Summary:

This paper sets out the executive's conclusions following its assessment of the application from CILEx and ILEX Professional Services Limited seeking a recommendation to the Lord Chancellor for designation as an approved regulator for probate activities and reserved instrument activities.

It summarises the process followed in making the assessment and the conclusions against the criteria for approval in Schedule 4 to the Legal Services Act 2007. It contains more detailed commentary on the key issues that have arisen in the assessment. It also summarises the advice received from the mandatory consultees and ILEX Professional Standards representations on that advice.

The full application is not included in this report but can be found on the LSB website¹ (where it has been published since 3 April 2013). A copy is available to any board member and will be available at the board meeting.

Recommendation(s):

The Board is invited:

1. to grant the application under Schedule 4, Part 2, paragraph 14(1) and make a recommendation to the Lord Chancellor under Schedule 4 Part 2, paragraph 16(2) that CILEx be designated as an approved regulator for probate activities and reserved instrument activities
2. To delegate to the Chairman the approval drafting of the recommendation
3. To delegate to the Chairman and the Chief Executive approval of the drafting of the final decision notice

Risks and mitigations

Financial: N/A

Legal: N/A

¹ Add link to application on the website

Reputational:	Although the Board is able to grant the application, the timetable for designation (assuming that the recommendation is accepted by the Lord Chancellor) is controlled by the Ministry of Justice (MoJ) and there may be a period of some months before this is completed. There is a risk that LSB is seen as the cause of the delay.
Resource:	There is a Statutory Order process following a recommendation in favour of designation. This, when taken together with the other applications for designation from the Institute of Chartered Accountants in England and Wales and Chartered Institute of Patent Attorneys/Institute of Trade Mark Attorneys, may require a significant proportion of the resources available for statutory decisions which may impact on other applications

Consultation	Yes	No	Who / why?
Board Members:		√	
Consumer Panel:	√		Required to seek the advice of the Panel on designation applications (Schedule 4, paragraph 5(2) of the Act)
Others:	Required to seek the advice of the Office of Fair Trading and the Lord Chief Justice on designation applications (Schedule 4, paragraph 5(2) of the Act).		

Freedom of Information Act 2000 (Fol)		
Para ref	Fol exemption and summary	Expires
NONE		

LEGAL SERVICES BOARD

To:	Committee (e.g. Board)	
Date of Meeting:	Date of Meeting	Item: Paper (13) 81

Application from the Chartered Institute of Legal Executives/ILEX Professional Services Limited seeking a recommendation to the Lord Chancellor that for designation as an approved regulator for reserved instrument activities and probate activities

Background

1. The Chartered Institute of Legal Executives (CILEx) is an approved regulator under the Legal Services Act 2007 (the Act) for the reserved legal activities of the exercise of a right of audience, the conduct of litigation and the administration of oaths. ILEX Professional Standards Limited (IPS) is the body to which CILEX has delegated its regulatory functions.
2. On 25 March 2013 CILEx and IPS submitted an application under Part 2 of Schedule 4 to the Act seeking a recommendation from the Legal Services Board (LSB) to the Lord Chancellor that an order be made designating CILEx as an approved regulator for the reserved legal activities of reserved instrument activities and probate activities.
3. In July 2010, CILEX/IPS made applications to the Board seeking designation for the conduct of litigation and probate activities. Those applications proposed the introduction of regulatory arrangements which would have allowed legal executives conducting reserved legal activities to set up independent businesses for the first time. Our analysis at that time was that work was necessary in relation to developing the entity regulation framework and regulations and in building IPS resource and knowledge to be an effective regulator of the new activities and of entities. The litigation application was granted but the regulatory arrangements approved at that time limited the granting of authorisation to conduct litigation only to Associate Prosecutors of the Crown Prosecution Service. IPS decided to withdraw the application relating to probate activities in July 2011.
4. Since then CILEx and IPS have invested resources into developing a better understanding of the market that they seek to regulate and in developing their regulatory infrastructure. Throughout this process they have engaged with the LSB culminating in these applications.

Assessment against the statutory criteria

5. The application was made under Part 2 of Schedule 4 to the Act. Paragraph 13(2) of Schedule 4 sets out the criteria on which the Board must be satisfied

before it can grant an application. Our assessment against these criteria is as follows:

Criteria	Assessment
The applicant would have appropriate internal governance arrangements (Schedule 4, paragraph 13(2)(a))	<p>Criteria met</p> <p>Under the LSB’s Internal Governance Rules (IGR) CILEx is an applicable approved regulator² and has been required to submit dual self-certificates on compliance with the IGRs. The last certificate was submitted in May 2013 and no issues relating to independence were identified. No issues on independence have been raised in the assessment of the application.</p>
The applicant would be competent, and have sufficient resources, to perform the role of the approved regulator in relation to the reserved legal activity at that time [point of designation (Schedule 4, paragraph 13(2)(b))	<p>Criteria met</p> <p>Please see paragraphs 12 – 16</p>
The proposed regulatory arrangements make appropriate provision (Schedule 4, paragraph 13(2)(c))	<p>Criteria met</p> <p>We are satisfied that the regulatory arrangement that IPS propose to use are fit for purpose. This includes regulations for</p> <ul style="list-style-type: none"> • Authorisation – please see paragraphs 17 to 24 • Practise rules – minimum practise requirements are have been defined as: <ul style="list-style-type: none"> ○ Practising address in England and Wales ○ Requirement to comply with the Code of Conduct (including PII and Compensation Fund provisions) ○ Duty to declare prior misconduct ○ At least one approved manager must be able to conduct reserved legal activities ○ Obligation to meet any requirement or conditions placed on the authorisation ○ Requirement to notify IPS of any material changes • Conduct rules – the Code of Conduct is clear about

² An applicable approved regulator is one that is responsible for the discharge of regulatory and representative functions in relation to legal activities in respect of persons who primary reason to be regulated by that approved regulator is those persons qualifications to practise a reserved legal activity regulated by that approved regulator

	<p>the standards that must be achieved</p> <ul style="list-style-type: none"> • Disciplinary arrangements – the Investigation, Disciplinary and Appeal Rule have been appropriately amended so that they cover the new reserved legal activities and to apply to authorised bodies as well as individuals. See paragraph 38 on intervention powers • Qualification arrangements – CILEx has a long history of developing and awarding qualifications to individuals to allow them to undertake reserved legal activities and the qualification schemes for reserved instrument activities and probate activities are built on these existing arrangements. The application contains a qualification regime for each of the applied for activities which are based on competency frameworks setting out the learning outcomes to be evidenced from both knowledge and experience. In addition, anyone who seeks to be approved as a Compliance Manager in an IPS authorised entity will be required to demonstrate competence in practice management and accounts management and administration. Continuing Professional Development Rules are in place • Indemnification arrangements – see paragraphs 25 to 29 • Compensation arrangements – see paragraphs 30 to 32 • Other rules and regulations <ul style="list-style-type: none"> ○ Accounts Rules (which include the requirements for handling client money) have been developed and are appropriate
<p>The proposed regulatory arrangements comply with the requirements imposed by sections 52 and 54 of the Act relating to the resolution of regulatory conflict (Schedule 4, paragraph 13(2)(d))</p>	<p>Criteria met</p> <p>The Authorisation Rules (Rule 8) stipulate that where there is a conflict between the requirements of the individual’s and entity’s regulators, the requirement of the entity regulator prevails.</p> <p>IPS recognise the risk of conflicts with other (non-legal) regulatory regimes and will rely on the principles in contained in the Framework Memorandum of Understanding (of which IPS and a number of other regulators are signatories) to resolve any conflicts.</p>

<p>The proposed regulatory arrangements comply with the requirements imposed by sections 112 and 145 of the Act in relation to the handling of complaints (Schedule 4, paragraph 13(2)(e))</p>	<p>Criteria met</p> <p>The Code of Conduct requires that those regulated by IPS act competently in the best interests of the client. This includes an obligation to provide full information on the complaints procedure and the right to refer the matter to the Legal Ombudsman (Code of Conduct Principle 5).</p> <p>In addition, Principle 4 requires that they comply with “legal and regulatory obligations and deal with regulators and ombudsmen openly, promptly and co-operatively”.</p>
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The assessment process

6. The application consisted of
 - an executive summary setting out CILEx/IPS vision of their future regulatory offering
 - an application document
 - the proposed scheme rules
 - supporting appendices
7. The application has been subject to a detailed analysis and issues identified have been logged in an issues log in the usual way. All issues identified have been closed to our satisfaction.
8. In addition to e-mail exchanges on the issues, there have been three meetings with the IPS executive including a visit to the IPS offices in Bedford to meet the team and review in more detail the proposed authorisation and supervision arrangements. This included a presentation and discussion on the entity risk framework and the results of the pilot exercise of those arrangements
9. If this application is approved, it would result in a significant expansion of regulatory scope. In the light of this, we felt it appropriate to consider in a little more detail the governance of the project to make the application and how this would continue if the application were to be successful. In particular we wished to understand how the IPS Board had been engaged in the development of the regulatory schemes and infrastructure and how it would continue to satisfy itself that the schemes are delivering what was intended.
10. Dawn Reid and Fran Gillon, Director of Regulatory Standards met with IPS Board member Hilary Daniel (HD) on 22 August. HD has specific responsibility for providing Board oversight and challenge to the development of the schemes, and has played an active role in the working group. The discussion covered the following areas; HD background and experience as a non-executive board member; her role on the IPS board as “lead” for governance and process; how the IPS Board has been engaged with the development of the schemes and applications; risks for IPS if the application is granted.

11. From the discussion we were satisfied that there had been an appropriate level of Board oversight in the development of the application; that the Board are alert to and actively managing the threats to both successful completion of the application and implementation projects and the “live” risks; that there was adequate reporting to the Board to allow it to identify risks and issues. HD’s role as the Board lead on this will continue post designation.

Specific Issues

Competence and capacity of IPS to regulate the new activities and entities

12. In 2010 one of the concerns that we discussed with IPS was the resources it had to deliver regulation of the new reserved legal activities and of entities. In particular we were not satisfied that sufficient work had been undertaken to properly identify the market(s) in which IPS regulated entities were likely to be operating. Nor were they able to demonstrate at that time that there was sufficient capacity and experience within the IPS executive to be an effective regulator.

13. Since then CILEx has committed considerable resources to IPS to allow it to develop. Of particular note are

- A research project to identify the interest in and appetite for the new reserved legal activities and the opportunity to set up independent practices
- Development of the IPS structure
- Recruitment of people with actual experience of regulating entities. Some of this recruitment was completed before the application was made so their experience could benefit the application
- In relation to the authorisation and supervision process, piloting (albeit in a very narrow set of situations) the proposed operating arrangements
- The development of a risk committee structure which will enable risks to be actively identified and managed. The Strategic Risk Committee (SRC) will be made up of independent appointees who will set the risk appetite and oversee the application of the risk framework to ensure that risks are appropriately identified. The independent membership of the SRC is a good “check and balance” for the IPS executive as the system is implemented and becomes established
- The IPS team now consists of 16 roles. Of these, 15 have been filled. The key role of Head of Operations (who will be responsible for authorisation and supervision) is yet to be filled. IPS have indicated they are ready to start recruitment for this key role once the application to the LSB is granted.

14. A significant change in the team structure does in itself attract some operational risks, particularly if the scope of activity is expanding significantly. IPS have managed this through a phased recruitment; this programme has enabled them

to bring in people with relevant experience thus mitigating the risks associated with doing new and expanded activities.

15. We are satisfied that IPS have taken appropriate steps to put itself into a position of having sufficient resources with relevant experience to enable to authorise and regulate both the new activities and entities.
16. An implementation plan has been developed to ensure that all the remaining actions are completed before designation. The plan is regularly reviewed by the working group and is on track.

Authorising persons to carry on reserved legal activities

17. IPS has extensive experience in authorising individuals to conduct reserved legal activities where they have met the education and qualification criteria. Those arrangements will continue to apply to individuals wishing to exercise these new reserved legal activities.
18. If approved the regulatory arrangements would allow IPS to authorise and regulate entities for the first time – this would enable Chartered Legal Executives undertaking reserved legal activities to set up independent businesses (until now those who have been undertaking reserved legal activities have done so under the supervision of another authorised person, most commonly a solicitor). Since this was an area that was least well developed when the applications were submitted in 2010, this has been an area of particular focus in this assessment.
19. The proposed entity regulation regime has the following features
 - A risk assessment framework which assesses impact (environment, size) and probability (history, leverage, dependency, systems) criteria.
 - applicants being subject to a basic risk assessment which will lead to a risk score which will determine firstly whether they should be authorised by IPS and, if they are so authorised, the supervision regime that will follow
 - An advanced risk assessment, which would include a pre-authorisation site visit, for firms where higher or more risks are identified
 - Annual data returns
 - Annual risk assessment once authorised
 - A consumer feedback mechanism to be delivered through a “specialist lawyers” website; all authorised firms will be required to participate in the website
20. The risk assessment framework has been piloted with IPS firms who offer immigration advice and services. Although a very small sample and mainly sole traders, this has enabled some testing of the framework. Following this initial trial, some amendments were made and a second pilot is now underway with Chartered Legal Executives who currently operate independently (but who do not deliver reserved legal activities – e.g. employment advisers). In addition, IPS has

been able to test the proposed framework on two firms that are currently authorised by the SRA.

21. Inevitably, the pilots being small means that is the risk that it may not have identified all of the issues. IPS is alert to this possibility.
22. Another risk factor is that currently it is a very paper based system. IPS is in the process of developing an IT system, which will include a risk assessment element, as part of a wider systems development project. Until that is in place (currently expected to be late summer 2014), then the results of any risk assessment will be recorded on a central database but this has some limitations in terms of reporting and identifying issues.
23. While this has some risks, IPS projections on the number of entities seeking authorisation is modest; mid-range estimate is that 30 - 85 individuals seeking the authorisation to conduct the new reserved activities may also seek entity authorisation in the first year. At this level, IPS will be able to develop more detailed knowledge of firms thus mitigating the risk that a significant or systematic issue will be missed.
24. The same risk assessment framework will be used as part of the ongoing supervision of firms. Post authorisation, firms will be required to submit an annual return and the information from this and other intelligence will be used to determine the degree and timing of supervisory activity. All firms will be allocated to a Relationship Officer who will propose the supervisory regime for each. IPS is aware of the risk of "regulatory capture" of Relationship Officers. This will be mitigated by ongoing reviews of individual assessments and randomly selected risk review visits to test the assessment process.

Indemnification arrangements

25. The proposed regulatory arrangements include a requirement that regulated entities maintain an appropriate level of professional indemnity insurance (PII).
26. The arrangements are modelled on those in the SRA Handbook and include a qualifying insurers agreement (between IPS and insurers); minimum terms with a minimum level of cover of £2 million and a requirement to maintain more if the business requires it; specific requirements on the actions to be taken in the event that the firm cannot secure PII at renewal, including a requirement to arrange run-off cover.
27. If a firm decides to secure extra cover, this is not subject to the rules and can be secured from any insurer, not just a qualifying insurer.
28. In developing these arrangements IPS have sought expert advice through which they have gained assurance that there is capacity and willingness in the open market to provide the necessary cover.
29. Our assessment is that these arrangements are appropriate.

Compensation arrangements

30. IPS has decided to establish a compensation fund. This will initially be funded by CILEx from reserves with an insurance policy alongside. Overtime, the fund is expected to build up with a view to removing or reducing the requirement for an insurance policy.
31. It is necessary for the fund to be established by CILEx, as the approved regulator, but it will be run by independent trustees who will be appointed by IPS. The trustees will make the final decision on whether a grant is made under the scheme. Recruitment of trustees is planned and prepared; this will start once the timetable for designation is set .
32. IPS intend that all entities will be required to make a contribution to the Compensation Fund. LSB has been advised that a compulsory contribution must have a statutory basis. This is to be achieved through an order under section 69 of the Act which is currently being considered by MOJ. We are satisfied that this is sufficiently advanced to allow us to make this recommendation. However, any designation order as an approved regulator will have to follow the s69 order; MOJ colleagues are aware of this and responsible for the correct sequencing of orders.

Advice from the mandatory consultees

33. In accordance with paragraph 5(2) of Schedule 4, the Office of Fair Trading (OFT), the Legal Services Consumer Panel (LSCP) and the Lord Chief Justice (LCJ) were invited to provide advice on the application. In giving his advice, the LCJ considered the advice of the OFT and LSCP.
34. IPS were invited to make representations on the advice.
35. Annex A contains a summary of the advice received and the IPS representations. Both the advice and the representations were published on the LSB website on 19 August 2013. Full copies will be available at the Board meeting.
36. The advice from the mandatory consultees and IPS representations have not identified any significant issues that would cause us to refuse the applications.
37. We have noted the Lord Chief Justice who gave the advice (Lord Judge) expressed his overriding concern that regulatory competition could have an adverse impact on regulatory standards. The Board will recall that we have previously been robust in our comments about not pursuing regulatory competition as an objective in itself, but we do have to apply the tests in the Act when a regulator seeks to add new reserved activities. In this case, we are satisfied that the arrangements that IPS have developed are capable of delivering an appropriate standard of regulation.

Other statutory orders

38. In addition to the designation order, a section 69 order will be required so that CILEx/IPS has powers necessary to be a regulator of entities. Specifically, it is seeking intervention powers that mirror those that are granted to licensing authorities on designation. It also seeks powers to make rules relating to grants from the Compensation Fund and to require authorised persons to make a contribution to the Compensation Fund.
39. Drafting of the order is progressing and we will issue a consultation paper on the order once the relevant MOJ reviews have been completed.
40. It will be necessary for the Section 69 order to be in place before the designation order comes into force. On the current timetable, MOJ expect that both the Section 69 and the designation orders will be laid before Parliament in October 2014, coming into force at the end of November. We will continue to work with IPS and MOJ to identify opportunities to expedite this.

Conclusion / 'next steps'

41. Since 2010 CILEx/IPS has made significant investment in preparing itself to be able to make these applications. In that time, they have taken into account the LSB's feedback and continued to engage with us as the proposals have developed.
42. IPS has significantly increased its resources, recruiting individuals with experience of the new activities and entities to supplement the existing team. The regulatory arrangements that have been developed for the authorisation of entities have been tested (albeit in a limited way) and this testing suggests that they are fit for purpose.
43. There are still some actions to be completed before they are fully in a position to authorise and regulate the new activities and entities. IPS has taken a cautious approach to this (wanting a degree of certainty about whether the application will be successful). There is an implementation plan that is being actively managed and reviewed and should ensure that everything is in place at the point of designation.
44. Statutory orders need to be completed. MOJ is actively engaged with this and are responsible for proper sequencing

Recommendations

The Board is invited:

- to grant the application under Schedule 4, Part 2, paragraph 14(1) and make a recommendation to the Lord Chancellor under Schedule 4 Part 2,

paragraph 16(2) that CILEx be designated as an approved regulator for probate activities and reserved instrument activities

- To delegate to the Chairman the approval drafting of the recommendation
- To delegate to the Chairman and the Chief Executive approval of the drafting of the final decision notice.

19.11.2013