

LSB Consultation: Reviewing the Internal Governance Rules

February 2018

Response from CILEx Regulation



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.

(i) Overall, since their introduction in 2009, there has been infrequent disagreement on regulatory independence matters between CILEx Regulation and its approved regulator.

Both parties introduced and review annually a Protocol which sits below the IGR. This provides a framework to enable the Chartered Institute of Legal Executives (CILEx) in its capacity as approved regulator and CILEx Regulation to fulfil their approved regulator and independent regulator functions as set out in the Legal Services Act 2007 (the 'Act'), and in accordance with the objects of the organisations set out in their Charter and Byelaws, and Memorandum of Association respectively.

From inception of the IGR, CILEx Regulation was established as a separate limited company, operating independently in almost all areas, albeit it is a wholly owned subsidiary. This corporate structure, the presence of a Protocol and the shared values that exist between the two organisations have delivered, on the whole, a successful model for regulatory independence. It is only over the last two years that CILEx Regulation has moved to a model of financial independence.

During its infancy, CILEx Regulation sought to acquire a number of significant new rights for authorisation for its regulated community, under delegation from the approved regulator. CILEx Regulation's starting point was not the same as for some of the other regulatory bodies, many of whom 'opened their doors' with a full suite of regulatory services. Part of the work involved in securing those rights required significant financial investment by the approved regulator in order for it, and CILEx Regulation, to demonstrate sufficient capacity and capability to decision-makers such as the Legal Services Board (LSB).

Over several years, the resourcing requirements developed and strengthened at CILEx Regulation. Financial investment was made by the approved regulator, largely from reserves rather than a 'levy' on the practice certificate fee payer. Now that CILEx Regulation is in delivery stage, it has been moving towards full financial independence. We might liken the situation to a young adult finding their feet financially having been supported by their parents.

Last year was the first independent financial operating year for CILEx Regulation. This transitional period is the one that has tended to throw up the most questions over the scope of the approved regulator's oversight role since the inception of the IGR.

(ii) CILEx has always demonstrated an understanding of the need to make reasonable resources available. This is captured by the Protocol.

The challenges that have arisen are largely when a request for reasonable resources has been made which falls outside the budgetary cycle. This could be triggered by an external requirement, for example, the requirement to contribute to the funding of a joint initiative, such as the Legal Choices website. The challenge only arises in the ability of either party to



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make additional resources available. Other challenges may relate to strategic direction or changes to the corporate governance arrangements.

Alternatively, it could be a request from CILEx Regulation to fund a workstream which it deems essential, but is only deemed desirable by CILEx. In the majority of instances, the IGR have not been used to moderate such challenges. CILEx Regulation has sought to rely on the Protocol and, if necessary, external advice.

Question 2: What are the benefits and costs to stakeholders of operating under the existing IGR framework?

The main benefit is knowing that an independent set of rules exist, which sit outside any internal governance arrangement between the approved regulator and the regulatory body. The costs involved largely relate to the time spent reaching agreement as to their interpretation and/or intent, and often requires external advice. The consumer is also a stakeholder. The impact of any changes that may be made that would improve the level of understanding about the sector to this stakeholder need to be taken into account.

Question 3: Do you agree with option 1: no change to the IGR? Why or why not?

It would appear from informal discussions that have taken place between the LSB and its stakeholders in the lead up to this consultation, that there is a case for change. CILEx Regulation agrees there is a case for change.

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?

Under our corporate structure, being a wholly owned subsidiary means on paper that our relationship exists through ownership. So to an external eye, we are not independent in the purest sense. It is through the delegations which derive from the Act, the AAR's Charter and Byelaws and underpinning Protocol which enable operational independence. Perhaps the distinction in this scenario is that the directors of CILEx Regulation have fiduciary duties which require them to make decisions in the best interests of the company, which may not always align with the interests of the parent.

Added to this, CILEx Regulation belongs to a Group structure which is currently undergoing significant governance reforms. Board papers have been shared in advance of Board meetings with the AAR's Council, inviting questions and comment. CILEx Regulation has presented updates and attended every AAR Council meeting since inception.

Financial performance is reported to the AAR by Group Services, together with other performance information such as LSB decisions, self-assessments, changes to corporate governance. Transparency should avoid the necessity of duplication of information. In



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particular, although full budgetary and other financial information needs to be shared directly with the AAR, the AAR could rely for its assurance on overall competence and performance on the requirements in the LSB's new self-assessment performance framework.

The information that will be shared with the AAR, which is the chartered body operating through a lay majority Group Board under the new Group structure, will relate to governance, finance, risk and educational matters. A new Protocol will govern the relationship between CILEx Regulation and the AAR and the starting point is for there to be full transparency of information between both parties.

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?

It is always helpful if an oversight regulator can act as a critical friend and provide a steer or clarification in an informal setting by way of limiting disputes before they arise. Where they have arisen, an informal dispute resolution mechanism would be a valuable service. Unless the LSB identifies a need for a formal approach to be followed, CILEx Regulation feels that the level of intervention sought is best indicated, certainly initially, by the AAR or regulatory body.

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

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

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

Please see response to question 15 below.

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

Question 10: What new obligations would you recommend the LSB prioritises, and why?

Question 11: What do you anticipate the impact of those proposed new obligations would be, and why?

Please see response to question 15 below.



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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?

Whilst the definition has not caused any particular issues for CILEx Regulation in practice, if there is a view that the definition is too narrow and/or imprecise then it is right that it should be re-visited.

Question 13: What do you anticipate the impact of revising the AAR definition would be, and why?

It is arguably confusing for consumers and the sector, that an AAR has representative functions. Anything that delivers clarity to 'end-users' can only be a good thing, setting aside the practicalities of the current arrangement for those directly involved. Anecdotal evidence would suggest many in the sector think the approved regulator is the frontline regulatory body.

Question 14: Do you agree that the definition of regulatory independence should be revised? Why or why not? If so, how do you think the definition should be revised, and why?

As for question 12 response above.

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

Until the LSB has reviewed the responses to this consultation, all permutations of Option 2 are plausible. CILEx Regulation supports the call for greater clarity around the residual role of the AAR. Option 2c would offer a platform to start afresh and focus the IGR on the 'gateways' and areas of legitimate oversight by the AARs.

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?

Not all AARs and their regulatory bodies are governed in the same way. For this reason, CILEx Regulation believes that the AARs and regulatory bodies should take the lead together in identifying permissible channels for information and assurance to flow between themselves. Where agreement cannot be reached, or parties are not able to use this method of collaborative working, then it would of course be helpful for the LSB to set out over-riding gateway principles that can be used as a starting point.



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Whatever the mechanism, there needs to be a collaborative approach and a willingness by parties to reach a position which satisfies both, without compromising the objectives of either. This is the approach favoured by CILEx Regulation. Largely, it has been successful.

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?

As for the response to question 16, overriding standards or benchmarks may be helpful.

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?

This depends on the nature of the assurance sought. For example, if a regulator continues to make approaches for reasonable resources, outside of the annual budget setting cycle, then you would expect that the AAR has a legitimate entitlement to seek assurances from the regulatory board that the justification for these continued requests is exceptional. That should, of course, be clearly stated to the AAR when the request is first made. By way of example, if CILEx Regulation becomes aware of an exceptional circumstance, it would notify the AAR informally (at officer level) and continue to keep the AAR updated on any change in situation. This avoids unannounced, surprise calls on resources, supports a transparent relationship and is good business practice.

The only downside to this approach might be a tendency for one party to then stray from oversight into operational detail. It is here that all parties would benefit from clarity within the IGRs, particularly in relation to the boundaries and extent of AAR oversight in relation to seeking additional assurance.

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

CILEx Regulation believes a gateway approach would offer clarity to the AAR and regulatory body as to the relevant and appropriate levels of oversight and independence.

Question 20: What, if any, alternative approach to reviewing the IGR do you suggest the LSB should consider, and why? What impact do you think that would have, and why?

You can't please all of the people, all of the time. A balance needs to be struck between the LSB delivering the change sought by the majority of stakeholders, who are at the sharp end of operationally delivering the regulatory objectives, and the current legislative framework which we know will remain in place for some time.



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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?

Depending on the option chosen arising from this consultation, it would seem sensible to add IGR compliance to the LSB's regulatory performance assessment. The early iterations for the dual self-certification (DSC) were labour intensive and, in some areas, seemed to duplicate other reporting requirements. The LSB will be aware that each stakeholder is subject to differing models of internal decision-making stages, which should be borne in mind. The question must be, what is the intended outcome of a DSC? Can this be achieved through any existing mechanism?

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?

See answer 21. A simple declaration of compliance, either joint or separate between the parties, should be considered.

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?

CILEx Regulation relies on the Protocol with CILEx in relation to resolving disputes informally. The distinction between compliance and non-compliance is arguably too subjective to make it an effective obligation in practice.

Question 24: Do you agree with third party assurance? If so, why? What do you anticipate the impact of this would be, and why?

Although an added cost and impact on timeframe, CILEx Regulation found third party review of its self-assessment, prior to submission to the LSB, of value. This was commissioned by CILEx Regulation, not in conjunction with the AAR, and we included in the terms of reference that the third party should flag any areas where they felt best practice was not being maximised.

Question 25: What, if any, alternative approaches to assuring compliance with the IGR do you suggest the LSB should consider, and why? What do you anticipate the impact of these would be, and why?

No alternative approaches suggested at this time.



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