

## The Law Society and Solicitors Regulation Authority

### Part One: summary and recommendation

#### Summary

Individual PCF is reduced by 9.4% from £320 in 2015/16, to £290 in 2016/17. Firm (recognised and licensed bodies) is reduced by 4.5% from £62.7m collection in 2015/16 to £59.9m collection in 2016/17. The collection is done on the basis of banded scale of turnover – the higher the turnover, the more the firm is required to pay - calculated from information supplied by each of the firms as part of the 2015/16 renewal exercise.

- Total Law Society budget and PCF income is £99.85m compared to £105.84m in 2015/16.
- PCF to apply as follows:
  - SRA £53.5m (£54.1m 2015/16)
  - Law Society Professional Body Permitted Purposes £31.11m (£35.3m 2015/16)
  - Statutory Levies (LSB, LeO and SDT) £15.24m (£16.4m 2015/16)
- With respect to contingency arrangements and reserves, TLS Group has reserves totalling £122.3m and accounting reserves of £71.1m (as of end May 2016).

#### Recommendation

- That the application be approved.
- That the decision letter:
  - Welcome reduction in PCF level for individuals and firms
  - Note the Law Society Group capital IT investment plans and its confirmation of how it will deal with risk of overspend, which is that if it sees early indications of a funding problem arising later in the programmes, it will revisit issues such as scope, timing and delivery approach, rather than automatically accepting an increased cost of delivery. The LSB would like to be kept informed if this occurs.
  - Comments on the reference in the application to advice from Counsel and an accountancy firm to the Law Society in 2015, in relation to commercial income. On the basis of that advice, the application reasserted that income that is generated from permitted purposes is free from the ambit of section 51 even if the activities are funded by practising fees. The application for 2016/17 did not include a proposal for this “commercial income” to be treated as outside the scope of the LSB’s approval decision. Therefore this particular issue is not material to your application and has not formed any part of the LSB’s consideration in its assessment of the 2016/17 fee level. Nonetheless, the letter makes clear that any proposals made in the future in respect of the allocation of financial resources received by an approved regulator from its permitted activities will be taken into consideration in deciding the appropriate level of practising fee to be borne by authorised persons. When considering all PCF applications, the LSB will also have regard to the compatibility of the proposal with the regulatory objectives and its other statutory duties.

## Part Two: Assessment of the application against LSB acceptance criteria

1. Pre-submission	
Were there any pre-submission discussions or a draft application; were any issues identified	<p><b>Yes.</b></p> <p>A meeting with representatives from SRA and The Law Society (TLS) was held on 30 June 2016, after which a draft of the application was reviewed.</p>
Were there any areas for improvement or specific issues in the last approval letter	<p><b>Yes.</b> In last year's approval letter, the LSB:</p> <ul style="list-style-type: none"> <li>• Recorded that the LSB is pleased that the level of PCF for individuals and firms would not be increased for 2015/16, but express concern that this is against the background of the total SRA budget falling for the third consecutive year, despite the SRA's increased contributions to TLS Group shared services. This is in addition to other reductions such as the decrease in the LSB and the Legal Ombudsman levy, as well as a reduction in the Solicitors Disciplinary Tribunal costs.</li> <li>• Noted that collection of fees at the approved level is expected to result in an over collection of approximately £2.4m. But said that while this was not ideal, it was a very small proportion (just 2.3% of the £105.8m total) income collected from PCF. The LSB said it was reassured that this would be held in permitted reserves and applied to reduce the net funding requirement for 2016/17.</li> <li>• Made clear that the LSB would not have had time to consider the new approach which TLS had originally proposed on the use of commercial income generated from permitted purposes for non-permitted activities, within the usual timescale of dealing with a PCF. But also to record our appreciation of the withdrawal to allow the LSB time to consider the issues.</li> <li>• Commented on the SRA planned review of fees and charges. The application confirmed that the SRA is finalising the scope of a project which will include options for changes to practising fees, other fees for regulatory activity and the Compensation Fund. Following enquiries in our assessment, the SRA confirmed that it expected to be in a position to update the LSB with a more specific timetable in October/November 2015 and that the SRA offered to discuss its current thinking with us to understand how it can align its work to the LSB work on the cost of regulation.</li> </ul>

	<p>In this year's application, the SRA confirms that it is currently consulting on significant changes to its regulatory arrangements. The current fees policy will be reviewed in the context of these changes to ensure that it remains appropriate and consistent with the requirements placed on the SRA by the LSA 2007.</p>
<p><b>2.Developing the application and budget</b></p>	
<p>Is it clear that the regulatory arm has led the development of the application?</p>	<p><b>Mostly.</b></p> <p>Covered in Section 2 of application. As in previous years, the application was developed and settled in line with agreed arrangements between the SRA and TLS. The SRA's draft budget and net funding requirement (NFR) is approved by the SRA Board and recommended to the Law Society Council by the Business Oversight Board (BOB).</p> <p>In November 2015, changes were made within the Law Society Group to the organisational structure through which support services are provided to both the SRA and TLS. Up until November 2015 finance, HR, IT, procurement and internal audit services were provided to the whole Group by a separate function known as Corporate Solutions (CS). Following a review of that arrangement whereby CS budget was apportioned between the SRA and TLS (CS was independently led and allocated its own budget approved by the BOB - which was also responsible for the governance of CS), it was decided to move some responsibilities and staff from this centre and into the SRA and TLS. In addition the leadership of the remaining shared service functions was transferred to be jointly managed by the SRA and TLS.</p> <p>Following a review, it was decided to disband CS and move some responsibilities and staff into SRA and TLS reporting lines. The remaining shared services functions are jointly managed by SRA and TLS.</p>
<p><i>Budget</i></p> <ul style="list-style-type: none"> <li>Is it clear how the budget has been arrived at</li> </ul>	<p><b>Yes.</b></p> <p>Application sets out both how TLS and SRA budgets are set.</p>

Is there evidence that the immediate and medium terms needs have been taken into account

The application explains that the NFR for the Law Society Group is based on draft budgets for the SRA and TLS (with both incorporating appropriate allocations of shared service costs) plus the levies that will be required by the LSB, Solicitors Disciplinary Tribunal and Legal Ombudsman. The draft budgets for the SRA and TLS for 2016/17 incorporate the costs of functions transferred from the former Corporate Solutions (see below) into each of the two businesses (the SRA and TLS). The allocation of these costs has been reviewed as a part of the draft budget and NFR process. In order to translate the total NFR into proposed fees, assumptions have been made about the number of practising fees issued and the turnover from all firms.

The Law Society Group financial year ends on 31 October, so the budget year is aligned to the Practising Certificate year. The NFR is based on draft budgets for the SRA and TLS. Final budgets for each are finalised before the beginning of the financial year. In the pre-meeting with TLS/SRA, it was also confirmed that confirmed they were confident, based on historical experience, about assumptions of the number of fee-payers (and therefore income).

**Yes.**

The SRA's strategic approach to the budget was set out in section 3 application and covered immediate and medium term needs.

The context for the preparation of the 2016/17 SRA budget is:

- The SRA Corporate Strategy 2014/15 – 2016/17
- The SRA's 2016 operational and financial position, including levels of activity both in 2016 and projected into 2017
- The SRA's assessment of current regulatory challenges and priorities and operational performance.

It takes into account that the SRA's programme of regulatory reform will continue in 2017. This includes the reviews of the Handbook, compensation and professional indemnity arrangements and regulatory fees and charges, as well as delivery of phase two of the Training for Tomorrow programme. The SRA will also be continuing its wide engagement programme with stakeholders.

The application also refers to the SRA's continuing aim of improving operational performance, with work taking place to develop and improve its technical capabilities, decision making framework and delivering effective operational quality assurance. The SRA will also be progressing with structural

<p>If the proposal is to increase the PCF, does the application include a forecast budget for the current application and, where available, the next three years and estimate of PCF for the next three years.</p> <p>Are the contingency fund arrangements clear</p>	<p>changes to the Legal and Enforcement, Intelligence and Investigations, Supervision and Client Protection Directorates. The financial assumptions which formed the business cases for these changes have been incorporated into the draft of the 2016/17 budget.</p> <p>With regards to TLS, practising fees are only applied for permitted activities and it is only the expenditure on these activities that is included within the NFR and the PCF. Each year to assess NFR for the forthcoming year each cost centre owner is required to set out the activities to be undertaken by their department in the following year. IT investment contributes to both permitted and non-permitted purposes within TLS. TLS is planning a total spend £4.4m of the overall Group £13.8m investment.</p> <p><b>N/A</b> The proposal is not to increase PCF.</p> <p><b>Yes.</b></p> <p>At the end of May 2016 the Law Society Group had cash reserves totalling £122.3m and accounting reserves of £81.1m. It is intended to utilise £4.2 m from reserves to fund TLS activity in 2016/17. That is, £2.4m to support activities that fall within the definition of permitted purposes and £1.8m to support activities that are outside of permitted purposes under the Legal Services Act.</p> <p>The section of the application that includes information on contingency arrangements and reserves, also outlines the Law Society Group’s capital IT investment plans. The total gross investment capital (that is, before the realisation of programme benefits) over the period 2015/16 to 2019/20 is currently estimated as £61m, with the net cost being £37m. Investment within the programme is front loaded with the investment in 2016/17 estimated to be up to £30m.</p> <p>The LSB asked how TLS/SRA proposed to manage risk of overspend on the IT investment and consequent additional call on reserves.</p>
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	<p>The Law Society Group explained that the cost estimates for the IT transformation programmes are based on detailed analysis and planning. They include amounts for contingency. Work has also been undertaken on the benefits to be realised from the programmes, including reductions in future operating costs.</p> <p>At this stage the Law Society Group has been conservative in modelling the financial benefits of the programmes and its aim is to increase these, thus reducing the net cost of the programmes. The modelling of the investment/benefit, and thus the net cost for each year of the programme lifecycle identifies that in 2017/18 the Group will again need to part fund the programmes from reserves; that is included in its future financial forecasts and has been approved by the SRA Finance and Audit Committee, SRA Board and Management Board, the Law Society Council and the BOB.</p> <p>Given the way in which the programmes have been planned and costed, and the way in which they will be delivered, the Law Society Group does not expect cost overruns. Should it see early indications of a funding problem arising later in the programmes it would revisit issues such as scope, timing and delivery approach rather than automatically accepting an increased cost of delivery.</p>
<p><i>Consultation</i></p> <ul style="list-style-type: none"> <li>• Has the proposed fee been consulted on – if so summarise</li> </ul> <p>Was the consultation clear about the level of fee and how it will be collected</p>	<p><b>Yes.</b></p> <p>TLS published a consultation on the proposed level of the NFR and fee publicised this widely.</p> <p>In addition, in 2015/16 both the SRA and TLS also undertook programmes of engagement and consultation to inform the development of the programmes of work and services provided. The application states that it is the output of this engagement and consultation, in the form of the strategies and forward work programmes for both TLS and SRA, on which the draft budgets and funding requirements are based.</p> <p><b>Yes.</b> Set out TLS Group’s NFR and how it will be spent, as well as the estimated practising fee for 2016/17. The consultation did not cover how the fee will be collected, however a communications plan is in place to inform individuals and firms about the 2016/17 fees, including the Compensation</p>

<p>Has feedback been fully considered</p>	<p>Fund contributions which was approved by the LSB by <a href="#">exemption direction</a> on 12 August 2016. The purpose of the plan is to ensure that the regulated community and relevant stakeholders know about the 2016/17 fees structure, the fees calculator and the levels of fees to be collected.</p> <p><b>Yes.</b> An analysis of the consultation responses was considered and circulated to all Law Society Council members before the Council made its final decision on the total amount to be collected in fees. An executive summary of the consultation response is attached to the application at Annex D.</p>
<p><i>Clear and transparent</i></p> <ul style="list-style-type: none"> <li>• Is the information provided to fee payers on the level of fee clear and transparent</li> <li>• When was/is this issued to fee payers</li> </ul>	<p><b>Yes.</b></p> <p>As referred to above, a communications plan was drawn up to inform individuals and firms about the 2016/17 fees, including the Compensation Fund contributions. The purpose of the plan is to ensure that the regulated community and relevant stakeholders know about the 2016/17 fees structure, the fees calculator and the levels of fees to be collected.</p> <p>Communications activity that has already happened includes:</p> <ul style="list-style-type: none"> <li>• An announcement was sent out in April 2016. This included an outline of the fee structure for practising fees for this year and inviting comment on how fees are spent was announced in the SRA's newsletter to the profession, SRA Update, which is sent to 200,000 recipients, including all those with a mySRA account.</li> <li>• The June SRA Update promoted the release of the calculator and the Law Society's consultation on fees and it was also promoted through Compliance News, the newsletter just for compliance officers and those focused on compliance issues, around 11,000 recipients</li> <li>• A reference to the online calculator going live was made in Professional Update, the Law Society's weekly newsletter</li> </ul>

	<ul style="list-style-type: none"> <li>• In June 2016 the online calculator with indicative individual fees, a revised turnover table and indicative Compensation Fund contributions was made available</li> <li>• There was a media release to promote these developments on June 22</li> <li>• There was a media release on the SRA Board's decision on fee determinations on 13 July</li> <li>• The decision was promoted through SRA Update on 19 July 2016</li> </ul> <p>Post LSB decision:</p> <ul style="list-style-type: none"> <li>• There will be updated fees pages on the SRA website (with caveat that LSB still needs to approve) that explain how fees are spent</li> <li>• The LSB approval will be publicised in a media release in mid-August</li> <li>• All news releases are circulated to groups such as the Sole Practitioners" Group, the Association of Women Solicitors, and the Association of Black Lawyers, for publication in their in-house newsletters and website</li> <li>• All news releases are also publicised through social media channels, namely Twitter, LinkedIn and Facebook</li> </ul>
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### 3. Permitted purposes

Is there evidence that the PCF income is used solely for permitted purposes	<p><b>Yes.</b></p> <p>All PCF income has been attributed to permitted purposes activity (Table 2). £99.85m total fee income against £99.85m fee expenditure on permitted purposes. The split of income according to Table 2 is £53.50m to SRA and £31.11m to TLS, the remainder attributed to the LSB/LeO levy and SDT.</p>
Is any other income to be applied to permitted purposes	<p><b>Yes.</b></p> <p>Table 7 of the application shows that of the £69.4m allocated to regulatory functions, £53.5m is from PCF income, zero funding from reserves, £12.5m of funding comes from recoveries (Compensation Fund and legal recoveries) and £3.4m is from 'other' income.</p>

### 4. Regulatory functions

Is there evidence of how much of the PCF income is applied to permitted purposes that are regulatory functions	<p><b>Yes.</b></p> <p>Total income and expenditure allocated to the regulatory functions of the SRA is presented in table 7 of the application. This shows that income allocated to the permitted purposes for regulatory functions by directorate totals £69.4m income for SRA, £53.5m of which will come from PCF income.</p>
Are any shared services clearly explained	<p><b>Yes.</b></p> <p>Section 5 of the application explains the shared services budget, NFR and allocation of costs to SRA and TLS. As explained in section 2 of this assessment, in November 2015,</p>



	<p>changes were made within the Law Society Group to the organisational structure through which support services are provided to both the SRA and TLS. The application explains that this means there will be a significant break in the historical time series on cost allocation for a number of the shared services items and the transfer of a number of activities and costs directly into the SRA and TLS, and the move of responsibility for the remaining shared service activities under the joint management of SRA and TLS.</p> <p>Table 11 shows the shared services budget and NFR. The NFR for 2015/16 was £47m. Following the transfer of activities and costs the remaining budget for shared services for 2015/16 was restated to reflect the revised structure. This resulted in a remaining budget in shared services of £19.1m which is directly comparable to £16.8m in 2016/17. The application explains that this represents a reduction of £2.3m in the cost of shared services from 2015/16 to 2016/17. Expected increases in investment income reduce the call on the practising fees by a further £600k.</p>
<b>5. Regulatory and equality impact assessment (optional requirement)</b>	
<ul style="list-style-type: none"> <li>• Completed and included?</li> <li>• If not included, is there an explanation of the potential impact</li> <li>• Does the application contain commentary on the regulatory objective and the Better Regulation Principles</li> </ul>	<p><b>Partly.</b></p> <p>While nothing specific on the regulatory impact of this PCF (it is going down), the SRA's programme of regulatory reform will continue in 2017 and will deliver the SRA's first two strategic objectives. Key priorities will include: the revision of the SRA's regulatory arrangements and Handbook, the reviews of compensation arrangements, fees and charges and Professional Indemnity Insurance and the delivery of next phase of the Training for Tomorrow programme.</p> <p>On equality, the SRA published its three year Corporate Strategy and Equality, Diversity and Inclusion Strategy in November 2014. This draft budget has been developed with a view to delivering year three of these strategies.</p> <p>Nothing on better regulation principles specifically.</p>
<b>6. Consultation with non-commercial bodies (optional requirement)</b>	
<ul style="list-style-type: none"> <li>• Does the application include a description of the steps taken</li> <li>• Have the proposed fees been shared with such bodies</li> <li>• What was the response</li> </ul>	<p>There is no reference in the application to consultations with non-commercial bodies.</p>
<b>7. LSB Review</b>	
<p>Have we consulted with any other body on the application</p>	<p><b>No.</b> Not considered necessary.</p>

Were any issues raised by LSB colleagues from the first review

**Yes.**

Three issues were raised:

- 1) The LSB noted that the application included reference to advice from Counsel and an accountancy firm to the Law Society in 2015, in relation to commercial income. On the basis of that advice, it is asserted that income that is generated from permitted purposes is free from the ambit of section 51 even if the activities are funded by practising fees. The application for 2016/17 did not include a proposal for this "commercial income" to be treated as outside the scope of the LSB's approval decision. Therefore this particular issue is not material to any decision the LSB makes about this application.

However, the LSB has commented on this in the decision letter making clear that any proposals made in the future in respect of the allocation of financial resources received by an approved regulator from its permitted activities, will be taken into consideration in deciding the appropriate level of practising fee to be borne by authorised persons. We remind TLS/SRA in the letter that this is set out in the Practising Fee Rules 2016. When considering all PCF applications, the LSB will also have regard to the compatibility of the proposal with the regulatory objectives and its other statutory duties.

- 2) It was asked how running cost control has contributed to the ability for TLS/SRA to reduce PCF this time around?

*The SRA responded that it had been careful not to attribute the reduction in proposed fees to cost reductions in the SRA and TLS (and shared services) as, although they exist in the underlying numbers, they are difficult to explain succinctly. However, cost reduction and improved efficiency across the Group have enabled the Law Society and SRA to set the funding requirement at the level proposed.*

*In 2015/16 the SRA's funding requirement was £56m compared to £53.5m in 2016/17. £0.6m of this reduction is due to a transfer of shared service costs to the Society from SRA. However, £1.9m is pure reduced cost. In 2015/16 this amount was met from Group reserves. If the SRA had not reduced running costs the 2016/17 requirement would have been £1.9m higher.*

*As can be seen from Table 4 of the application, this cost reduction comes both from core SRA operating costs (which will reduce by 1.5% in 2016/17 compared to 2015/16) and*

from the SRA cost of support services following on from the transfer of responsibility for these services from Corporate Solutions to SRA/TLS. Core SRA operating costs have been reduced from £40.5m in 2013/14 to £36.7m in 2016/17.

Core operating costs in shared service have, on a like for like basis, dropped from £19.1m in 2015/16 to £16.8m in 2016/17. This is a direct result of the new management focus on efficiency and cost reduction in this area since the restructuring and line-management changes of these functions in November 2015.

For 2016/17 the overall TLS cost of operations in respect of activity funded through regulatory fees is flat with 2015/16.

3) It was noted by the LSB that the individual fee reduction is greater in percentage terms than the firm reduction.

TLS Group produced a table (below) showing the split between firm and individual fees in terms of the total amount charged which illustrated a 7.4% reduction in the amount charged to individuals and a 4.5% reduction in the amount charged to firms. It was explained that the reason that these figures differ is that last year the split between firm and individual fees was not exactly 40/60 to allow the individual fee to be kept at £320. The actual split was 40.7% individual and 59.3% firms.

The figure of a 9.4% change refers to the reduction from £320 individual fee to £290. This reduction is partly due to the reduction in the total amount charged to individuals and also an increase in the number of individuals holding a practising certificate (the total amount charged to individuals is divided by the expected number of individual fee payers). As this number of fee payers increases the individual fee can reduce by a greater percentage than the reduction in the total amount charged to individuals.

	2015/16	2016/17	Reduction	% reduction
	£m	£m	£m	
Individual	43.1	39.9	3.2	7.4%
Firm	62.7	59.9	2.8	4.5%
<b>Total</b>	<b>105.8</b>	<b>99.8</b>	<b>6.0</b>	<b>5.7%</b>

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**Paul Greening, Regulatory Associate**

**22 August 2016**