

## The Law Society and Solicitors Regulation Authority

### Part One: summary and recommendation

#### Summary

- Individual PCF is reduced by 4.1% from £290 in 2016/17, to £278 in 2017/18. The firm fee (i.e. recognised and licensed bodies) is reduced by 1.2% from a total collected of £59.9m in 2016/17 to £59.2m total to be collected in 2017/18. The firm 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 2016/17 renewal exercise.
- Total Law Society Group budget and PCF income is £98.6m compared to £99.9m in 2016/17.
- PCF to apply as follows:
  - SRA £52.6m (£53.5m 2016/17)
  - Law Society Professional Body Permitted Purposes £30.6m (£31.1m 2016/17)
  - Statutory Levies (LSB, LeO, SDT and OPBAS) £15.4m (£15.3m 2016/17). To note, the levy for OPBAS (the Office of Professional Body Supervision) is £300k and is an initial estimate of year 1 costs to be charged.
- With respect to contingency arrangements and reserves, TLS Group has reserves totalling £131.1m and accounting reserves of £85.14m. This compares to £122.3m and £71.1m respectively shown for the 2016/17 application.
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#### Recommendation

- That the application be approved.
- That the decision letter:
  - Welcomes the reduction in the level of PCF for both individuals and firms again this year.
  - Comments on the very short consultation between 23 June and 2 July. While acknowledging that the PCF is being reduced and that the budgetary planning timetable means that there is a short window, the LSB considers it is unreasonable for there to be such a short consultation. We would like The Law Society Group to consider how it might better incorporate the views of the regulated community in future budget and PCF rounds.
  - Comments on The Law Society's allocation of expenditure between permitted and non-permitted activities. The Law Society changed its methodology of allocation of PCF revenue between permitted and non-permitted activities. The LSB has an interest in ensuring that any new approach does not lead inadvertently to monies raised from PCF being used for non-permitted purposes.
  - Notes that the further examples of how the allocation had worked in practice had not provided the re-assurance we sought, as it appeared that resources were being classified as for permitted purposes despite substantive elements of representative activity.
  - States we could not conclude our enquiries on this aspect in the time allotted to make a decision.

- However, as the PCF level is being reduced and taking into account that we were content with the SRA parts of the application, we did not consider it proportionate to refuse the application solely on the lack of clarity of allocation.
- Records that the LSB will continue to look into the matter of expenditure allocation and will be back in touch with The Law Society.
- Makes clear that if it transpires that PCF funds have been allocated to non-permitted activity through the new methodology and this has had an impact on the PCF level, we will expect an off-set correction in the PCF proposals for 2018/19.

## 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> A meeting with representatives from SRA and The Law Society (TLS) was held on 28 June 2017, 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>– Welcomed the reduction in PCF level for individuals and firms</li> <li>– Noted the Law Society Group capital IT investment plans and its confirmation of how it would deal with risk of overspend, which was 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 said it would like to be kept informed if this occurs.</li> <li>– Commented 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 was not material to the application and the LSB made clear it did not form any part of</li> </ul>

	<p>the LSB's consideration in its assessment of the 2016/17 fee level.</p> <ul style="list-style-type: none"> <li>– However, the decision letter also made 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 would be taken into consideration in deciding the appropriate level of practising fee to be borne by authorised persons. The letter added that when considering all PCF applications, the LSB will have regard to the compatibility of the proposal with the regulatory objectives and its other statutory duties.</li> </ul>
<b>2.Developing the application and budget</b>	
<p>Is it clear that the regulatory arm has led the development of the application?</p>	<p><b>Yes.</b></p> <p>TLS's draft budget and NFR is approved by the Law Society Management Board. The Law Society Management Board and finally the Law Society Council then discuss and agree the total Law Society Group budget.</p> <p>This is the second year following changes made in November 2015 within the Law Society Group to the organisational structure through which support services are provided to both the SRA and TLS. It was decided to disband the former Corporate Solutions 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>The 2017/18 draft budgets for the SRA and TLS – and therefore the NFR for each, include an allocation of shared service costs. The allocation of these costs was reviewed as part of the draft budget and NFR process. These allocations are reviewed annually.</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>The NFR for the Law Society Group is based on:</p> <ul style="list-style-type: none"> <li>• The SRA and TLS's draft budgets, which include Shared Services' costs; and</li> <li>• Levies required by:</li> </ul>

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

- the Legal Services Board (LSB);
- the Solicitors Disciplinary Tribunal (SDT);
- the Legal Ombudsman (LeO); and
- the Office of Professional Body Supervision (OPBAS), initial estimate of year 1 costs to be charged to the regulator.

The Law Society Group's financial year ends on 31 October, so the budget year is aligned to the practising certificate year. Budgets for the SRA and TLS are finalised before the beginning of the financial year within the individual NFR envelopes set at the point of this application.

**Yes.**

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

- the draft SRA Corporate Strategy 2017/18 to 2019/20;
- the SRA's 2016/17 operational and financial position, including levels of activity both in 2017 and a forecast for 2018;
- the SRA's assessment of current regulatory challenges and priorities and operational performance; and
- the Modernising IT programme.

The SRA is also preparing its new three-year Corporate Strategy for publishing later in 2017. This draft budget has been developed with a view to delivering against this draft and the SRA is currently drafting the Business Plan for 2017/18 in readiness for the budget to be finalised in the autumn. The Corporate Strategy is being produced to respond to external changes since the last strategy produced and to reflect the current SRA priorities as considered by the Senior Management Team and the Board.

The application also outlines the SRA's programme of regulatory reform in 2017/18, and improving the organisation's operational performance through the medium and long term modernisation of the SRA's technological capability and IT.

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.

Are the contingency fund arrangements clear

Finally, the application refers to the greater budget certainty resulting from the provision of a sole supplier for the external work required to deal with disciplinary cases.

**N/A** The proposal is not to increase PCF.

**Yes.**

The application states that the SRA and TLS are expected to operate within approved budgets, reprioritising if necessary should unexpected needs arise in the year.

As at the end of May 2017, the Law Society Group had cash reserves totalling £131.1m and accounting reserves of £85.4m. It intends to use £2.2m from reserves to fund TLS activity in 2017/18 as follows:

£1.3m to support activities that fall within the definition of permitted purposes.

£0.9m to support activities that are outside the definition of permitted purposes under s51 LSA 2007.

Of relevance to the Contingency Fund is the SRA and TLS activities to address deficiencies in the IT on which both bodies rely. The full implementation of the IT roadmaps will result in the SRA and TLS having separate IT systems, specifically designed to support the different business needs of each body.

It is planned that the IT programme costs above the level of the capital provided for in the 2016/17 NFR will be met, first, by the use of any under spends in the 2015/16 capital budgets for the SRA and TLS and, second, through the use of reserves held by the Law Society Group. To the extent that Group reserves are used to fund these programmes, it is planned to replace

	<p>those reserves from future fee collections. Through the lifecycle of the programme the element of the NFR for capital investment for the Group will remain flat; meaning that towards the end of the programmes sums in excess of in-year expenditure will be collected and applied to restore the level of reserves. Following completion of the programmes“ lifecycle SRA and TLS expect to reduce the level of funding required for capital investment and collected through annual fees.</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>Has feedback been fully considered</p>	<p><b>Yes, but a very short consultation period</b></p> <p>TLS published a consultation on the proposed level of the NFR and fee and said it publicised this widely. However, it was very short consultation The consultation ran from 23 June – 2 July.</p> <p>While it was promoted on the website, via social media, the weekly Council and local law societies’ update, a headline story in Professional Update and a letter to the editor from the president in the Gazette, there were only 96 responses out of a membership of around 130,000. While it could be argued that given that the proposal was for the fee to go down, a large response would not be expected, this is an aspect which the LSB has seen cause to comment on in the decision letter (see Section 7 of this assessment).</p> <p><b>Yes.</b> In 2016/17 both the SRA and TLS undertook programmes of engagement and consultation to inform the development of the programmes of work and services provided. It is the output of this engagement and consultation, in the form of the strategies and forward work programmes for both bodies, on which the draft budgets and funding requirements are also based. The SRA also publishes an online calculator which allows firms to work out what their individual fee will be.</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</p>

	consultation response is attached to the application at Annex D.
<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>A communications plan is in place to inform the individuals and firms about the 2017/18 practising fees, including the Compensation Fund contributions. (A link to the LSB decision notice on the Compensation Fund contributions can be found <a href="#">here</a>.) The purpose of the communications plan is to ensure that the regulated community and relevant stakeholders are informed of:</p> <ul style="list-style-type: none"> <li>the 2017-18 fees structure;</li> <li>the availability of the fees calculator to help them; and</li> <li>the level of fees to be collected.</li> </ul> <p>Communications activity that has already happened includes: Updated fees webpage on the SRA website (with caveat that LSB still needs to approve), which explain how fees are spent, an online fee calculator, a revised turnover table and indicative Compensation Fund contributions, was published on 23 June.</p> <ul style="list-style-type: none"> <li>An SRA news release to promoting changes to the Compensation Fund contributions went out on 23 June, this included a link to the Law Society Group consultation on practising fees for 2017/2018.</li> <li>A Law Society news release outlining the joint consultation was sent out on 23 June.</li> <li>Information on the changes to the Compensation Fund contributions was in the SRA's June newsletter to the profession, SRA Update, was sent to 200,000 recipients. This included a link to the Law Society Group consultation on practising fees for 2017/2018</li> </ul> <p>Planned communication activities post-LSB decision:</p>

	<ul style="list-style-type: none"> <li>• An SRA news release on the SRA Board's decision on fee determinations will be issued in July.</li> <li>• The SRA Board's decision will be promoted through Compliance News in July, the newsletter for compliance officers and those focused on compliance issues (around 11,000 recipients).</li> <li>• LSB approval of the fee levels will be publicised in a media release in mid-August.</li> <li>• The LSB approval and final fees will be promoted through SRA Update in September, which is sent to 200,000 recipients, including all those with a mySRA account.</li> <li>• All news releases are published on the SRA website and promoted through social media channels (Twitter, LinkedIn and Facebook).</li> <li>• Reference to the online calculator going live was made in Professional Update, the Law</li> <li>• Society's weekly newsletter.</li> </ul>
<b>3. Permitted purposes</b>	
<p>Is there evidence that the PCF income is used solely for permitted purposes</p>	<p><b>Generally yes, although some LSB concerns.</b> All PCF income has been attributed to permitted purposes activity (Table 3). £98.6m total fee income against £98.6m fee expenditure on permitted purposes. The split of income according to Table 3 (draft 2018 budget) is £52.6m to SRA and £30.6m to TLS, the remainder attributed to the LSB/LeO and OPBAS levies plus SDT.</p> <p><b>However, see section 7 of this assessment with regards to LSB concerns about TLS expenditure allocation to permitted purposes.</b></p>
<p>Is any other income to be applied to permitted purposes</p>	<p><b>Yes.</b> Table 9 of the application shows that of the £68.5m allocated to regulatory functions, £52.6m is from PCF income, zero funding from reserves, £12.9m of funding comes from recoveries (Compensation Fund and legal recoveries) and £3m is from 'other' income.</p>



<b>4. Regulatory functions</b>	
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 9 of the application. This shows that income allocated to the permitted purposes for regulatory functions by directorate totals £68.5m income for SRA, £52.6m of which will come from PCF income.</p>
Are any shared services clearly explained	<p><b>Yes.</b></p> <p>Section 5 and Table 12 of the application explains the shared services budget and NFR. It shows a total NFR for 2017 of £16.8m. There is a draft 2018 shared budget of £16.4m. The allocations for 2018 are £5.8m to TLS and £8.9m to SRA.</p> <p>According to the application, the allocation of shared service costs between TLS and SRA has been reviewed as part of the NFR submission to ensure that the charge to both bodies correctly reflects the drivers of costs within shared services.</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>No.</b></p> <p>As the PCF as it is being reduced, there is no regulatory or equality impact assessments. There is reference to the SRA having built on the strategy and programme set out in its current Corporate Strategy with very significant engagement and consultation on regulatory standards through the Question of Trust programme. The application goes on to say that the engagement is informing the SRA's comprehensive programme of regulatory reform, which, among other benefits, should reduce unnecessary administrative burdens on firms. By introducing greater flexibility in the Handbook, the SRA hopes to free up firms to operate their business in a way that suits them best. The SRA' aim is that this will remove regulatory barriers and therefore costs.</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> </ul>	<p>There is no reference in the application to consultations with non-commercial bodies.</p>

<ul style="list-style-type: none"> <li>• Have the proposed fees been shared with such bodies</li> <li>• What was the response</li> </ul>	
<b>7. LSB Review</b>	
Have we consulted with any other body on the application	<b>No.</b> Not considered necessary.
Were any issues raised by LSB colleagues from the first review	<p><b>Yes.</b></p> <p>Two principle issues were raised:</p> <p><b>1) Short consultation.</b> The consultation was for little over a week and practically only 5 working days. While acknowledging that the PCF is being reduced and that the budgetary planning timetable means that there is a short window, the LSB considers it is unreasonable for there to be such a short consultation. Our decision letter will make clear that we would like The Law Society Group to consider how it might better incorporate the views of the regulated community in future budget and PCF rounds.</p> <p><b>2) The Law Society’s new methodology of allocation of PCF revenue</b> between permitted and non-permitted activities raised concerns for us. It appeared that under the new methodology, there had been a significant percentage ratio increase in resources allocated to permitted activities, against non-permitted, compared to previous years.</p> <p>The LSB has an interest in ensuring that any new approach does not lead inadvertently to monies raised from PCF being used for non-permitted purposes.</p> <p>The Law Society provided examples of how the allocation had worked in practice, which included The Junior Lawyers Division being allocated a permitted purposes activity code despite many of its activities being representative.</p> <p>We could not conclude our enquiries into this aspect of the application in the</p>

	<p>timeframe for making a decision. We therefore concluded that we will need to make further enquiries subsequent to this decision.</p> <p>If it transpires that PCF funds have been allocated to non-permitted activity through the new methodology and this has had an impact on the PCF level, we will expect an off-set correction in the PCF proposals for 2018/19.</p> <p>Please see the Recommendation section of this assessment which sets out the LSB position to The Law Society and SRA on the matter.</p>
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**Paul Greening, Regulatory Associate**

**16 August 2017**