

## The Law Society and Solicitors Regulation Authority

### Part One: summary and recommendation

#### Summary

- Individual PCF remains unchanged from 2017/18. The total collected from firm fees (i.e. recognised and licensed bodies) is £59.8m in 2018/19 compared to £59.2m in 2017/18. The firm collection is unchanged 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 2017/18 renewal exercise.
- Total Law Society Group budget and PCF income is £99.7m compared to £98.6m in 2017/18.
- PCF to apply as follows:
  - SRA £52.6m (the same as for 2017/18)
  - Law Society Professional Body Permitted Purposes £30.6m (the same as for 2017/18)
  - Statutory Levies (LSB, LeO, SDT and OPBAS) £16.5m (£15.4m 2017/18). To note, the levy for OPBAS (the Office of Professional Body Supervision) is £300k - an initial estimate of year 1 costs to be charged to the regulator.
- With respect to contingency arrangements and reserves, TLS Group has cash reserves totalling £129.4m and accounting reserves of £82.14m. This compares to £131.1m and £85.4m respectively for the 2017/18 application.

#### Recommendation

- That the application be approved.
- That the decision letter:
  - Welcomes the stabilisation of PCF levels.
  - Records that the LSB is pleased to see there was a longer consultation period on the fee and that the LSB will do all it can to provide the SRA with the necessary information going forward to enable it to consult as early as possible.
  - Notes that the application states that it is planned that any IT programme costs above the level provided in the 2018/19 budget will be met by the use of reserves held by The Law Society Group. Furthermore, that where Group reserves are used to fund these programmes, it is planned to replace those reserves from future fee collections. While acknowledging that following completion of the IT programme lifecycle and the repayment of reserves, SRA and TLS expect to reduce the level of funding required for capital investment collected through annual fees, the LSB will expect more detail in the 2019/20 application on the likely impact of IT programme costs on reserves and therefore on the trajectory level of fees.
  - Reminds the Law Society that the LSB letter for the 2017/18 fee raised the matter of The Law Society allocation of funds to permitted and non-permitted activity. Records we were unable to fully consider this aspect in the period of assessment for that application, and made further subsequent enquiries. As a result of additional information provided by the Law Society we identified that internal legal guidance provided to cost centre managers was central to decision making on the allocation of funds to permitted and non-permitted purposes by the Law Society. Notes that LSB and TLS officials are continuing to engage on the guidance and the LSB will write separately once these further enquires and deliberations are complete.

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

<b>1. Pre-submission</b>	
<p>Were there any pre-submission discussions or a draft application; were any issues identified</p>	<p><b>Yes.</b> A meeting with representatives from SRA and The Law Society (TLS) was held on 2 July 2018 after which a draft of the application was reviewed.</p>
<p>Were there any areas for improvement or specific issues in the last approval letter</p>	<p><b>Yes.</b> In last year's approval letter, the LSB:</p> <ul style="list-style-type: none"> <li>– Welcomed the reduction in the level of PCF for both individuals and firms.</li> <li>– Commented 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 considered it was unreasonable for there to be such a short consultation. We recorded that the Law Society Group should consider how it might better incorporate the views of the regulated community in future budget and PCF rounds.</li> <li>– Commented 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.</li> <li>– Noted 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.</li> <li>– Stated we could not conclude our enquiries on this aspect in the time allotted to make a decision.</li> <li>– As the PCF level was being reduced and taking into account that we were</li> </ul>

	<p>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.</p> <ul style="list-style-type: none"> <li>– Recorded that the LSB will continue to look into the matter of expenditure allocation and will be back in touch with The Law Society.</li> </ul>
<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>Yes.</b></p> <p>In 2017 the Council of the Law Society resolved to alter its governance, creating a single Board to replace the four Boards (which included the Law Society Management Board). TLS's draft budget and net funding requirement (NFR) was approved by the Law Society Board and recommended to Council.</p> <p>The Law Society Board and finally the Law Society Council then discuss and agree the total Law Society Group budget.</p> <p>The 2018/19 draft budgets for the SRA and TLS – and therefore the NFR for each – include an allocation of shared service costs. The allocation of those costs has been reviewed as a 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.</li> <li>• levies required by: <ul style="list-style-type: none"> <li>– the Legal Services Board (LSB)</li> <li>– the Solicitors Disciplinary Tribunal (SDT)</li> <li>– the Legal Ombudsman (LeO)</li> <li>– the Office of Professional Body Supervision (OPBAS), initial estimate of year 1 costs to be charged to the regulator.</li> </ul> </li> </ul> <p>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</p>

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

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 published its three-year Corporate Strategy in November 2017. The NFR has been prepared to build on the objectives outlined in the strategy. The business plan, which is supported by the NFR and will set out the specific deliverables for year two of the three-year plan, will be finalised during the summer/autumn of 2018.

In preparing the 2018/19 budget, the SRA Board also considered a number of potential risks and has ensured suitable allowance has been made. These areas are broadly consistent with previous years, and include:

- information governance and ensuring compliance with and ability to meet the demands of the new rules that came into force with the new General Data Protection Regulations (GDPR) in May 2018
- the conclusion of its Modernising IT programme, delivery approach for IT services and ongoing development beyond that point
- increased requirements and complexities arising from the new AML supervision regime.

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

In summary, these included:

- the draft SRA Corporate Strategy 2017-2020;
- the SRA's 2017/18 operational and financial position, including levels of activity both in 2018 and a forecast for 2019;
- the SRA's assessment of current regulatory challenges and priorities and operational performance; and
- the Modernising IT programme.

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

**N/A** The proposal is not to increase the overall level of 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 2018, the Law Society Group had cash reserves totalling £129.4m and accounting reserves of £82.4m. It intends to use £2.5m from reserves to fund TLS activity in 2018/19 as follows:

- £1.1m to support activities that are outside the definition of permitted purposes.
- £1.4m to support in year IT transitional costs and funded from reserves generated by the SRA in the 2016/17 financial year.

Of relevance to the Contingency Fund is the SRA and TLS activities to address deficiencies in IT. The SRA and TLS have now commenced the implementation of the IT roadmaps in order to implement the IT reform programme. Both SRA and TLS are satisfied that the current IT presents significant business risks. Full implementation of the roadmap will separate IT systems to specifically support the particular operational needs of both. This should also reduce running costs and increase efficiency. The TLS and SRA expect the 2018/19 year to represent a move from shared services to organisational based.

The total gross capital investment from 2015-2020 is estimated at £61m. It is planned that any Group IT programme costs above the level provided in the 2018/19 budget will be met by the use of reserves held by the Group.

	<p>Group reserves may also be used to fund the IT infrastructure programmes of the SRA and TLS, and we note that the application says it is planned to replace those reserves from future fee collections. However, following completion of the IT programme’s lifecycle and the repayment of reserves, SRA and TLS expect to reduce the level of funding required for capital investment collected through annual fees.</p> <p><b>The LSB comments on this in the review section of this assessment and decision letter.</b></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><b>Yes</b></p> <p>TLS published a consultation on the proposed level of the NFR and fee and said it publicised this widely. The consultation ran from 12 June – 1 July. Longer than the consultation for the 2017-18 fee, which the LSB welcomes.</p> <p>It was promoted on the TLS website, via social media, the weekly Council and local law societies’ updates, a headline story in Professional Update and a letter to the editor from the president in the Gazette, there were only 60 responses. Given there was no change in individual and firm fees it is perhaps not surprising. Details of responses are presented in Annex D of the application. Bearing in mind the low response rate, key themes identified by TLS/SRA were:</p> <ul style="list-style-type: none"> <li>• PC fees do not represent value for money (53% said no; 28% said yes; and 18% didn’t know).</li> <li>• Lack of clarity about benefits of Law Society membership</li> <li>• While half of respondents think that the split of spending across the Law Society Group (i.e. Professional Body, SRA, levies etc) is reasonable, there was a suggestion that membership fees for TLS should be optional.</li> <li>• SRA should get less - there is no incentive for it to keep costs low (however, its cost have reduced down the years)</li> <li>• Pleased that the PCF has reduced</li> <li>• Want to see more on promoting the value of solicitors</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.</b> In 2017/18 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 particular 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.</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>A communications plan is in place to inform the individuals and firms about the 2018/19 practising fees, including the Compensation Fund contributions. (A link to the LSB decision notice on the Compensation Fund contributions can be found via <a href="#">this page on the LSB website</a>).</p> <p>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 2018-19 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 includes the following:</p> <p>Updated fees webpage on the SRA website (with caveat that LSB still needs to approve), which explains how fees are spent, an online fee calculator, a revised turnover table and indicative Compensation Fund contributions. This was published on 12 June.</p>

	<ul style="list-style-type: none"> <li>• An SRA news release to promoting changes to the Compensation Fund contributions went out on 12 June, this included a link to the Law Society Group consultation on practising fees for 2018/2019.</li> <li>• A Law Society news release outlining the joint consultation was sent out on 12 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 11,000 recipients. This included a link to the Law Society Group consultation on practising fees for 2018/2019.</li> </ul> <p>Planned communication activities post-LSB decision:</p> <ul style="list-style-type: none"> <li>• The PCF decision will be promoted through Compliance News in September, the newsletter for compliance officers and those focused on compliance issues.</li> <li>• The LSB approval and final fees will be promoted through SRA Update in September to around 200,000 recipients.</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 LSB concerns regarding the basis of allocation.</b></p> <p>PCF income has been attributed to permitted purposes activity (Table 3). £99.7m total fee income against £99.7m 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>



	<b>See section 7 of this assessment with regards to LSB concerns about TLS expenditure allocation to permitted purposes.</b>
Is any other income to be applied to permitted purposes	<b>Yes.</b> Table 8 of the application shows that of the £68.5m allocated to regulatory functions, £52.6m is from PCF income, £1.4 from reserves, £12.6m of funding comes from recoveries and £2.9m is from 'other' income.
<b>4. Regulatory functions</b>	
Is there evidence of how much of the PCF income is applied to permitted purposes that are regulatory functions	<b>Yes.</b> Total income and expenditure allocated to the regulatory functions of the SRA is presented in table 8 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.
Are any shared services clearly explained	<b>Yes.</b> Section 5 and Table 11 of the application explains the shared services budget and NFR. It shows a total NFR for 2018 of £16.4m. There is a draft 2019 shared budget of £14.1m. According to Table 12 the allocations for 2019 are £5.8m to TLS (the same as for 2018) and £6.6m to SRA (compared to £8.9m in 2018).  According to the application, the allocation of shared services costs between TLS and SRA has been reviewed as part of the NFR submission to ensure that the charge to both entities correctly reflects the drivers of costs within shared services.
<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>	<b>No.</b> As the PCF is not being increased, there are no regulatory or equality impact assessments. There was no specific mention of the better regulation principles. But the following information in the application is of relevance in setting out changes to the SRA's regulatory framework:

	<p>The SRA's programme of regulatory reform will continue in 2018/19, subject to LSB approval. Key priorities include:</p> <ul style="list-style-type: none"> <li>• continuing work to implement changes following its review of the Handbook</li> <li>• implementing changes to make it easier for consumers to access information that helps them find and choose an appropriate legal services provider</li> <li>• appointing a supplier to develop, test and deliver the Solicitors Qualifying Examination (SQE)</li> <li>• continuing with work to prepare operational systems and processes for the introduction of the SQE</li> <li>• developing and using its framework for evaluating the impacts of its reforms</li> <li>• continuing to refine the SRA's approach to anti money laundering regulation, including responding to external development</li> <li>• the SRA will also be continuing its wide engagement programme with stakeholders.</li> </ul>
<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>
<p>Key issues identified by LSB</p>	<p><b>Yes.</b></p> <p>Two issues:</p> <ul style="list-style-type: none"> <li>i) We noted the estimated total gross capital investment from 2015-2020 (see budget comments in section 2 above). Going forward there could be a potential impact on fee levels to replenish reserves which may be</li> </ul>

	<p>used for the IT modernisation programmes of the Group. For the 2019/20 application the LSB will expect more detail on the likely impact of IT programme costs on reserves and therefore on the trajectory level of fees.</p> <p>ii) For the second year there is a high proportion of PCF funds allocated to TLS permitted purposes. The LSB and TLS are continuing dialogue do the LSB can understand the internal systems and basis for such allocation.</p>
--	---

**Paul Greening, Regulatory Policy Manager**

**14 August 2018**