

<b>To:</b>	Legal Services Board	
<b>Date:</b>	21 January 2016	<b>Item:</b> Paper (16) 04

<b>Title:</b>	Review of Practising Fee Rules 2009	
<b>Workstream(s):</b>	Statutory Decisions	
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<b>Status:</b>	Official	

**Purpose of paper:**

This paper provides a summary of the findings of the review of the Practising Fee Rules 2009 and seeks the Board's agreement to a consultation on proposed changes to those rules:

- Inclusion of explicit reference that the Board will have regard to the regulatory objectives when considering PCF applications; and
- Inclusion of criteria that approved regulators will need to provide clarity and transparency about the impact of a proposed practising fee change in respect of the allocation of all its financial resources, whether or not those resources arise from permitted purposes

**Recommendation(s):**

The Board is invited to

1. note the outcome of the LSB review of the Practising Fee Rules 2009
2. Agree to the consultation on revisions to those rules
3. Delegate to the Chief Executive the drafting of the consultation paper

**Risks and mitigations**

**Financial:** None

**Legal:**

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

	<b>[REDACTED]</b>
<b>Reputational:</b>	Reputational damage to LSB if the rules and guidance are unclear. The rules will be subject to consultation; the guidance will be tested with approved regulators before publication.
<b>Resource:</b>	There is a small risk that competing priorities will restrict time available to ensure delivery of consultation and publication of revised guidance. Will ensure sufficient resource allocation and planning.

Consultation	Yes	No	Who / why?
<b>Board Members:</b>	√		Board members informed and views sought at 26 October 2015 board meeting
<b>Consumer Panel:</b>		√	
<b>Others:</b>			

Freedom of Information Act 2000 (Fol)		
Para ref	Fol exemption and summary	Expires
Risks and mitigations: Legal, Para 11, Para 14, Para 16	Section 42: information subject to legal professional privilege	

## LEGAL SERVICES BOARD

<b>To:</b>	Legal Services Board	
<b>Date of Meeting:</b>	21 January 2016	<b>Item:</b> Paper (16) 04

### Review of Practising Fee Rules 2009

#### Background

1. As set out in the paper submitted to the Board in October 2015, we have completed a review of the Practising Fees Rules 2009 (PCF Rules).
2. Section 51 of the Legal Services Act 2007 (the Act) specifies that income raised from practising certificate fees (PCF) can only be applied to permitted purposes. Under the Act the LSB must approve the level of fee before it is payable (section 51(5)), and the LSB must also make rules specifying the permitted purposes (section 51(3)).
3. In the summer of 2015, an issue arose in respect of the Law Society (TLS)/Solicitors Regulation Authority (SRA) PCF application for 2015/16, when in its draft application TLS proposed a different treatment of commercial income from previous years. It proposed to use income, including that arising from PCF funded permitted purposes (so called "derivative income") for non-permitted activities, and in future years also to be allocated to non-permitted reserves.
4. 'Derivative income' can arise from activities undertaken by the regulatory and representative arms of an approved regulator. In the case of TLS, the mandatory PCF paid by solicitors and firms can be used by TLS to fund the costs of, for example, providing accreditation schemes and certain training programmes (i.e. non-regulatory permitted purposes). In the past, income generated from those PCF funded activities has been used to 'net off' the costs of the permitted purposes and so reducing the level of PCF to be collected. Under the approach proposed (but withdrawn) by TLS, monies raised by charging for these PCF funded activities could have been applied for other non-permitted activities, which could include paying for TLS overheads or its commercial activities.
5. As it would have not been possible for the LSB to properly consider the implications of the new approach within our usual three week period for making decisions on PCF applications, TLS removed the proposal from the 2015/16 PCF application. We gave a commitment to TLS that we would review the handling of the issue in time for the 2016/17 PCF application.
6. In addition, the PCF rules are in any case overdue for a review. They were made in 2009 and many matters arising from our scrutiny of applications have

subsequently been the subject of comment in our decision letters. It seems sensible that we now review the rules in the light of five years' experience to test if they continue to meet the purpose for which they were intended and whether further clarification is required.

### **Approach to the review**

7. The conclusions and recommendations from the review are based on the following:

- A review of the existing rules and guidance
- A review of the each of the PCF decisions made over the last five years
- Meetings with the approved regulators (with the exception of the Institute of Chartered Accountants in England and Wales) to gain their feedback on the process
- Specific consideration of the derivative income issue

### **Main findings from the review**

8. The main conclusions from the review were as follows:

- Overall, approved regulators considered the rules reflect the requirements of the Act, are clear about the permitted purposes and there is no need for a radical alteration at this time. If changes are needed, these should continue to be expressed at a high level rather than having prescription in the rules.
- The guidance that has been published is valued by those preparing applications. If clarity is needed on any issues, then this is best addressed through revisions to the supporting guidance rather than changes to the rules. The current guidance should be reviewed and republished.
- There is a perception that the LSB has a one-size fits all approach to assessing PCF applications. The view was expressed that for the smaller regulators (particularly where the PCF income is used for purely regulatory activities) could be subject to less intense scrutiny than the larger regulators.
- Transparency of costs is an important consideration for the LSB when making a decision. This has arisen in relation to a number of issues including the allocation of PCF income to permitted purposes, reserves, the allocation of the cost of shared services (where relevant) and the presentation of the LSB/OLC levy (where there have been instances where the presentation has suggested that the levy is higher than it is).

- Approved regulators' consultation exercises on proposed fee levels are seen as a burden that does not add much to the process of setting fee levels. There is nothing in either the rules or guidance to indicate the frequency of consultation and all the approved regulators perceive that it was the LSB's expectation that there should be a consultation every year which many of the approved regulators felt is disproportionate. In part this may arise from the fact that the approach and outcome of consultation exercises is something that we have specifically commented on in decision letters in previous years.

*Derivative income*

9. The Act is silent on whether income derived from permitted purposes activity can be used in the way in which TLS proposes. It is also not covered in the PCF Rules. Whilst using income in the way proposed by TLS is not explicitly prohibited, since solicitors have no choice but to pay the PCF, we should question whether it is compatible with the regulatory objectives that income from activities funded by the non-optional PCF can be used for optional activities for which there may be little or no benefit to fee payers. This assessment could only take place in the consideration of a specific application for approval.
10. When considering a PCF application, the LSB must take into account the criteria for deciding applications that are set out in the rules. But there are also wider considerations beyond the requirements of section 51 of the Act. A PCF approval will be an exercise of the LSB's functions and in delivering that function and we must act in way that is compatible with the overall regulatory objectives.
11. [REDACTED]
12. While derivative income was one of the drivers for the review, it was not raised as the most prominent issue for most approved regulators. Nonetheless, feedback included the view that the use of income from permitted purposes for non-permitted activities, such as paying for overheads or a representative body's commercial activities, did not seem within the spirit of the Act, even if it was not explicitly prohibited by s51.
13. Having considered legal advice, we have concluded that the best way to address this is to amend the criteria for assessing applications set out in the PCF rules.
14. [REDACTED]

[REDACTED]

### **Conclusions and recommendations for changes**

15. In relation to the findings summarised in paragraph 8 above, we consider that these can be addressed through revisions to the guidance covering consultation exercises, transparency of costs and reserves, the allocation of shared services costs and presentation of the levy. This will be developed during the proposed consultation on a revision to the rules and published at the same time as the report of that consultation.
16. [REDACTED]
17. It should be noted that the proposed amendments does not specifically prohibit (or indeed mention) derivative income; this specific issue will be covered in more detail in the guidance.
18. In addition, we have concluded that the rules should be explicit that the LSB will have regard to the regulatory objectives when considering an application. This is to ensure that when discharging its duty under s51, approved regulators are clear that the LSB does so within the context of its wider statutory duties under the Act, in particular the regulatory objectives.
19. Annex A is a copy of the annotated rules.

### **Next steps**

20. Subject to the Board agreeing to the recommendations, we would commence an eight week consultation at the beginning of February. We consider that eight weeks is sufficient time given the limited group of stakeholders that will have an interest in the change and the fact that there has been some pre-consultation discussions as part of the review.
21. Any change to the rules will need to be approved by the Board (Schedule of reserved matters, 5.3). We expect to bring a further paper to the Board in May.

## **Recommendation**

22. The Board is invited to

- note the outcome of the LSB review of the Practising Fee Rules 2009
- Agree to the consultation on revisions to those rules
- Delegate to the Chief Executive the drafting of the consultation paper.

