

THE LEVY: Funding Legal Services Oversight Regulation

Consultation on the proposed rules (leviable operational expenditure) to be made under sections 173 and 74 of the Legal Services Act

A Response by the Institute of Legal Executives

Introduction and Summary

This response represents the views of the Institute of Legal Executives (ILEX) as an Approved Regulator (AR) under the Legal Services Act 2007 (hereinafter "the 2007 Act"). This response follows a meeting by an ILEX working party consisting of the President and Office Holders, together with a number of members sitting on the ILEX Council.

The 2007 Act provides for a levy to meet the expenditure incurred by the Legal Services Board (LSB), the Legal Ombudsman (LeO) and the Lord Chancellor in the establishment of the LSB and LeO and the ongoing costs associated with the carrying on of the LSB's and LeO's regulatory functions. This consultation document relates to the on-going costs.

Legal Services Board Levy

1. ILEX accepts that as an Approved Regulator we are a leviable body under the 2007 Act for the purposes of the imposition of the levy, but we are disappointed that the LSB would not be moved from its preferred option of leviable costs being calculated on a per capita basis. We believe this is an easy option with many flaws. It is only one measure of proportionality and ignores a targeted risk based approach. Whilst it may take into account the relative size of the Approved Regulators, and meet consistent methodology between the Approved Regulators, it does not have regard to the individual circumstances of regulated members. For example, the per capita basis will hit Legal Executive lawyers disproportionately hard in comparison to solicitors.
2. From the outset, ILEX has advocated a risk based approach in calculating the levy having regard, amongst things, to the number of complaints. For example, there would be little difficulty in calculating the levy by looking at the number of complaints historically and then making any necessary adjustments at the end of the year. We reject the notion that the risk based approach is more complex to calculate. Indeed, ILEX understands

that the risk based approach is being adopted by the Financial Services Authority in respect of insurance regulation. That said, we accept that *the final decision is for the LSB and* at this stage the per capita basis may be the most suitable option given that there is little data to consider the risk based approach. However, the LSB should not rule out the risk based approach entirely as and when more data becomes readily available

Levy for Running Costs for the Legal Ombudsman (LeO)

3. ILEX welcomes the Legal Ombudsman's proposals for its costs to be calculated on an average number of service complaints.
4. ILEX also makes the following additional comments:
5. Whilst ILEX understands that the LSB will be subject to some parliamentary scrutiny by virtue of s6 of the 2007 Act, we are concerned by the possible lack of scrutiny in respect the LSB budget.
6. As an Approved Regulator we are rightly and reasonably concerned with the setting and control of the LSB's budget, which will ultimately determine the overall leviable expenditure imposed on the Approved Regulators. For example: Expenditure is carefully monitored and controlled at ILEX. We are mindful that it is our members' money.
7. We expect the LSB and the LeO to be equally vigilant and are concerned at the lack of provision for external scrutiny. Further, we fear that the estimated LSB expenditure, including that of LeO may be seen as expenditure targets rather than expected maxima.
8. As a matter of principle, ILEX wishes to make clear that compliance with the requirement to meet the levy should not be treated as approval to the actual or proposed expenditure and that if, as ought reasonably to be the case, there is an underspend, there should be a refund (or other credit application) in favour of the ARs.

Time frame:

9. The proposed date 31st March 2010 is agreeable provided that ILEX receives the information in May/June the previous year. This would enable ILEX to successfully work the leviable expenditure into the budget and membership fee setting arrangements.
10. Subject to the general observations above, ILEX responds to the questions in the consultation document in the order that they are raised.

Question 1

Do respondents agree that the LSB's levy should be calculated on the estimated leviable expenditure and paid by 31 March 2011?

11. ILEX accepts that it needs to pay the leviable expenditure and ultimately the time frame in which it needs to be paid subject to the observations made in this response.
12. Given that the LSB is a relatively new organisation; there is an absence of a track record of forecasting activity levels. It is, therefore, imperative that the estimated fee is very close to the LSB's Business Plan otherwise it will not give the Approved Regulators any certainty to budget accurately.
13. ILEX is also concerned that the estimated leviable expenditure will also be susceptible to the following variables in any given annual forecast:
 - Need for further investment
 - Invocation of enforcement powers

- The extent to which the LSB may have to invoke direct regulatory or licensing activity.

14. Ultimately, it is the setting and control of the LSB's budget that will determine the leviable expenditure. In light of this, we expect there to be proper and transparent scrutiny of the budget and actual expenditure and arrangements for refund and/or credit of the underspend.

15. As a matter of completeness, the LSB's leviable expenditure excludes any costs incurred that may be reasonably attributed to its functions under s164 (power to establish a voluntary scheme for resolving complaints); s165 (making of orders under s164); and s166 (operation of a voluntary scheme). It is unclear from the consultation document whether such a scheme is to be established and how the costs of such a scheme will be ring fenced and not attributable to leviable expenditure.

Question 2

Do respondents agree that the Legal Ombudsman's levy should be calculated on the estimated expenditure and paid by 31st March 2011?

16. Subject to comments below, ILEX agrees with the approach to the proposed running costs of the LeO. ILEX Professional Standards (IPS) for the period 2009 had 18 complaints, of which only a few were service complaints. This can be considered de minimis and reflects the high standards that ILEX strives to maintain in respect of its membership. ILEX expects this situation to continue for some years until Legal Executive lawyers can fully participate in the ownership and management of Alternative Business Structures (ABSs).

17. The LeO's expenditure will be demand led on the number of complaints per year. Significant increases will therefore be reflected in an adjustment to the levy. Relatedly, the preferred approach will mean that the LeO's levy will result in the value of this element not being known until the

demand is received by the ARs sometime between January and March of each year. As a result the ARs will not have any indication of what to put in budgets, or what to set aside in liquid funds. As such, this will have a detrimental impact of the AR's ability to manage their cash and investments effectively. This undermines the proposition of the LSB that it will provide clarity and certainty to the ARs.

18. A more practical approach might be to set the allocation of the LeO levy in advance, based on prior data. This could then be adjusted retrospectively, perhaps quarterly in arrears.

Question 3

Do respondents consider the risk based approach is the most appropriate way of calculating the levy? If yes, can you suggest ways in which the risk for each regulator could be easily calculated and verified without adding additional costs burdens to the LSB, Approved Regulators and individual regulated entities and individuals?

19. The risk based approach endeavors to quantify the likely detriment in terms of both degree of severity and breadth of impact in the event that an AR's actions are contrary to the objectives of the 2007 Act. ILEX understands that this will be set out as follows:

- An objective assessment as to how each AR is performing in carrying out their regulatory duties
- Carrying out a risk profile of each AR (this would necessitate the LSB obtaining detailed knowledge of the operations of the AR)¹

¹ It has been suggested that one tool to determine this is the risk data that insurers use to calculate approved person's professional indemnity insurance.

20. ILEX believes that the Risk Based Approach is the most appropriate approach given the regulatory objectives but accept that at present the LSB may not have enough data to consider this. Nevertheless, it is essential that as soon more data is readily available; the switch to the risk based approach should be revisited and fully considered.

21. As regards the suggestion of a hybrid option consisting of authorised persons and regulated entities, ILEX is of the view that, without seeing the details of such a scheme, it seems to be too complex and over complicates matters, which may lead to cost burdens. Relatedly, there is a danger that entity regulation would subordinate individual regulation in any event.

Question 4 (option 2)

Do respondents consider the volume of activity generated by each Approved Regulator approach is the most appropriate way of calculating the levy? If yes, can you suggest ways in which we could easily and accurately apportion the current costs of our activities with future benefits and / or future work arising from activities?

22. This option examines the following in determining the leviable charge:

- Volume of activity generated by the AR; and
- The level of engagement by the LSB with the ARs.

23. This option assumes that the LSB would be focusing its work on those aspects of the profession that pose the greatest risks in not meeting the obligations under the 2007 Act. As such, costs would be apportioned on an "amount of work generated basis".

24. There is an inconsistency with this option in relation to the cost being on a per capita basis: at paragraph 4.19 of the consultation document, the LSB appears to accept that there is no necessary correlation between the amount of work undertaken by the LSB *vis-à-vis* the size of the population covered by the AR. This appears to undermine the LSB's main proposition that the leviable costs should be on a per capita basis. This lends support to our view that the adoption of the per capita basis is analogous to a poll tax on the regulated community.

25. As regards this option, it is difficult to envisage any cost benefit advantages, bearing in mind this would shift the data collection costs onto the LSB, and this would subsequently be cost recovered from the ARs and hence ultimately the regulated community and consumers.

Question 5 (option 3)

Do Respondents consider the number of authorised persons per Approved Regulator is the most appropriate way of calculating the levy?

26. We understand that this is the preferred option of the LSB because it is easy to administer and a simple approach that requires minimum collection of data. However, it does not follow that it is the best approach for the reasons cited below:

- It would have a disproportionate impact on ILEX Fellows (there are 7300 Legal Executive Commissioner for Oaths in employed practice, who would not have the advantage of off-setting the increased cost of the practising certificate (many on an average or below average salary) are being expected to pay the same per head as those running their own businesses));
- Costs being spread per head not having regard to the circumstances of individual ARs;

- Takes no account of tax positions of individual members;
- LSB considers that recoverability of AR costs are entirely up to the AR (this is a diffusion of responsibility as ultimately it would impact on members and consumers);
- It is only one measure of proportionality and fairness and does not take into account impact on regulated members and consumers; and
- Does not take into account entity based regulation

27. We accept that at this stage the per capita basis may be the most suitable option given that there is little data to consider the risk based approach. However, ILEX is of the view the LSB must not rule out the risk based approach entirely when more data becomes readily available.

Legal Ombudsman Costs

Question 6

28. From the outset, ILEX has been a strong supporter of the establishment of the LeO. That said, given the exemplary complaints record of its members, ILEX feels that the levying of its members on a per capita basis would have a disproportionate impact on ILEX and its members. For example, using the LSB's indicative figures would result in the ILEX levy being over £1 Million. This would not be proportionate, even within the LSB's own definition of fair principles.

29. We also reiterate that the complaints that are being counted also include misconduct complaints and not only service complaints. For example, IPS

only had 18 complaints last year (2009), of which only a small number would have been service level complaints.

30. In view of the above, ILEX feels it would be wholly disproportionate for it to be penalised for running what is essentially a tight and streamlined ship.

Question 7

Do respondents consider that there are more appropriate ways to estimate the likely number of service complaints and/or cases during the first few years of the Legal Ombudsman's operation (that is the period from the anticipated commencement in late 2010 to approximately 2013)?

31. ILEX reiterates the points raised in question 6 above. This proposal is proportionate and targeted against ARs who will be mainly responsible for the LeO's operational costs.

32. IPS for the period 2009 only had 18 complaints, of which only a few related to service complaints, which can be considered de minimis. ILEX does not envisage an increase to this figure. However, we expect some increase when IPS becomes licensing body for the purposes of *Part 5 of the 2007 Act*.

33. Let us also not forget that during the debates in the House of Commons and the House of Lords during the passage of the Legal Services Bill, it was recognised that the establishment of the LeO was largely dictated by the poor complaints handling by the Law Society. In view of this, it is safe to say that the Law Society will continue to generate the bulk of the work for the LeO. ILEX would suggest that another option is that at the end of the year, the actual cost could be apportioned by reference to actual complaints.

Question 8

Do respondents consider that levying specific Approved Regulators for costs attributable to them above a given threshold is the most appropriate way of recovering costs that are beyond the ‘business as usual’ costs? If yes, can you suggest how a threshold can be calculated and/or what its level should be? If no, can you suggest ways in which these costs should be cost-recovered?

34. ILEX agrees with the above proposition. Ultimately, if a specific AR incurs expenditure over and above the ‘business as usual’ then that AR should be approached to make good the extra expenditure incurred, otherwise AR’s would be acting essentially as insurance underwriters. It should not be for the other ARs to make good this loss at their expense.

35. ILEX is of the view that the ‘polluter pays’ principle is absolutely essential in determining the recoverable costs attributable to “business not as usual” scenarios. It is a principal that ILEX supports and would adhere itself in the unlikely event that we are responsible for the extra expenditure.

Question 9

What are your views on the proposed approach for the cancellation of designation of an Approved Regulator?

36. ILEX recognises that if an AR has done something which warrants them having to cease trading, then ultimately they will have to cease trading. However, having said that, ILEX would like to think that if a fellow AR is experiencing difficulties or thought that things were going wrong, they would have the foresight to recognise the problem and deal with it accordingly, seeking assistance where necessary.

37. ILEX is of the view, however, that there should be the option for the other ARs to make representations to pay the share of the levy for the AR in

difficulty or where the cancellation of designation is inevitable. This would allow another AR to consider regulating their members if appropriate.

Question 10

What are your views on the proposed approach with regard to ensuring that 100% of the levy is collected from all of the remaining ARs?

38. The LSB and the Legal Ombudsman accept that the above scenario is unlikely to happen but nevertheless needs to make provision for it. In the event it does happen, the AR's levy would be recouped from the remaining ARs.

39. ILEX does not agree with this approach as not only could this have a severe financial impact on some ARs but it also disregards the issue of responsibility.

40. If a large AR owing a substantial levy were to fail, the call on a smaller AR and even ILEX might be beyond its means and lead to another failure.

41. Responsibility for the approval of ARs rests with the LSB. It sees the data provided by the ARs, and so would be in a position to form a reasonable view as to any potential risk. Requiring other ARs to foot the bill if an AR fails penalizes those ARs where, on the face of it, the LSB has 'got it wrong'.

42. ILEX recommends that the LSB looks at the possibility of obtaining insurance cover. The LSB will be aware of its obligations and what it needs to do as the over-arching regulator; if the LSB considers it appropriate following a risk assessment, it should consider a bespoke insurance package, rather than expecting the remaining ARs to pay.

Question 11

What are your views on the proposed approach with regard to the levy arrangements for new ARs?

43. In the event the Lord Chancellor decides to make an Order designating a new AR after 1st April, it does not follow that a new AR will not have any complaints for that year. Arguably new ARs should pay a levy in the first year but on a pro rata basis. ILEX is of the view that the new designated AR should pay immediately upon becoming an AR. It may be de minimis but fair.

44. The other option is for the Lord Chancellor to hold designation until the following year. ILEX does not agree that there should be any time where a new AR does not pay any levy, but still require cover.

Question 12

Is the proposed date (by 31 March 2011) workable of the Approved Regulators?

45. The proposed date 31st March 2010 is agreeable subject to information being supplied by May/June the previous year. This would enable ILEX to successfully work the leviable expenditure into the budget, together with the opportunity of discussing any implications arising thereof. For example, the setting of membership fees, if necessary.

Question 13

Do the draft Rules accurately reflect the preferred approach (as set out in the consultation paper?)

46. Subject to the observations in this consultation response, ILEX has no comments on the Draft Statutory Instrument.