

Meeting: Legal Services Board

Date: 22 January 2020

Item: Paper (20) 04

Title: Review of PCF approval process and non-regulatory permitted purposes

Author(s) / Presenter/ Introduced by: Sally Al-Saleem/Chris Nichols

Status: Official

Introduction: Purpose of the paper/ Issue

1. The purpose of this paper is to explain the work we have conducted so far as part of our review of the Practising Certificate Fees ('PCF') approval process and targeted review of regulator's approach to non-regulatory permitted purposes and set out our direction of travel so the Board has an opportunity to provide its views.

Recommendation(s)

2. The Board is invited to:
 - Note the work which has been conducted to date
 - Provide views on our direction of travel, including the key themes which have emerged from our internal analysis of PCF applications, which we will discuss with Approved Regulators (ARs) and Regulatory Bodies (RBs)¹.

Timing

3. We are aiming to commence the first round of engagement through a series of bilateral meetings with ARs and RBs in February 2020 on the key themes which have emerged from our analysis of PCF applications over the last 2 years.

¹ ARs are responsible for submitting the PCF application but the RBs are responsible for setting the budget associated with regulatory functions.

Background

LSB assessment of PCF

4. Each year the LSB must assess and approve the ARs applications under section 51 of the Legal Services Act 2007 ('the Act'), for the approval of their respective PCF. Section 51(2) stipulates that an AR may only apply amounts raised by PCF for one or more of the permitted purposes listed in section 51(4) (included at Annexe A).
5. Section 51(3) and (6) of the Act places an obligation on the LSB to make rules in respect of the PCF approval. The current [LSB's Practising Fee Rules 2016](#) (Rules) set out the criteria we use to assess PCF applications. The [Guidance to Approved Regulators \(ARs\) on Practising Certificate Fee \(PCF applications\)](#) (Guidance) sets out the detailed evidence ARs are asked to provide in their application.

Rationale for review

6. Our process for assessing PCF applications remains largely unchanged since it was first introduced in 2011. In this time, the LSB's overall approach to regulation has evolved significantly. In particular, we introduced our regulatory performance framework in 2018. Now is a good time to consider how we can ensure that the PCF process is linked to regulatory performance and forms part of a coherent and joined up approach to regulation.
7. The review will also allow us to consider how we ensure that the PCF approval process is focussed on permitted purposes activities which support the regulatory objectives. It will also ensure that we have more clarity on the activities which are categorised as permitted purposes by ARs, so that we can consider whether they are appropriate and develop LSB policies on issues such as the methodology for the allocation of PCF, reserves and impact assessments.
8. We recognise that the PCF and permitted purposes are potentially controversial issues, because of the close association with the income of some of the representative bodies. However, we intend to approach the review from the perspective of making full use of engagement on the PCF as a means of driving a meaningful debate on the purpose, benefits and costs of regulation, on the basis that a better understanding of those issues ought to lead to improved standards across the sector. One implication of this is that we do not necessarily see reductions in the PCF as an incontrovertible outcome of the work; indeed, there is reason to consider that in some parts of the sector, regulation may be underfunded. We also intend to use it as an opportunity to see where transparency might be improved, to allow those that pay the PCF to drive accountability for the expenditure of PCF income and to inform the LSB's oversight responsibilities.

What we have done so far

9. Phase 1 of the project was completed in Q1 of 2019 and involved an internal review, development and publication of a PCF proforma based on the existing Rules. The aim was to refine the existing PCF application process, prior to the 2019 PCF cycle, to address issues around quality, lack of transparency and clarity in the information provided by ARs, particularly around non-regulatory permitted purposes activities. This has improved the quality of applications in 2019 and provided additional evidence that has helped to inform our work on the forthcoming review (which constitutes Phase 2 of the project).
10. In preparation for the review, the LSB obtained counsel's advice on interpretation of section 51 of the Act and the implications for the methodology for allocation of PCF to non-regulatory and regulatory permitted purposes.
11. We have assessed all PCF applications for 2018/19 and 2019/2020 with the purpose of identifying further themes, to inform our initial working proposals for discussion with ARs and RBs. These key themes and the detailed initial working proposals were discussed and approved by SLT in December 2019.

What we intend to do

12. We intend to commence a first round of engagement with ARs and RBs, by holding bilateral meetings to discuss the initial working proposals in February 2020. Once the first round of engagement is complete, we will invite ARs and RBs to participate in workshops on the key themes to facilitate transparent and collaborative discussions and build consensus for our proposals.
13. The proposals and an analysis of the ARs' and RBs' subsequent contributions will inform both a policy position paper and the proposed revisions to the PCF Rules and Guidance, which we will consult on in June 2020. We intend to implement the final Rules and Guidance in November 2020 ahead of the 2021 PCF cycle.
14. We have budgeted for the recruitment of a financial expert on a part time basis in 2020, to assist with our scrutiny of future PCF applications and to contribute to this project.

Key themes and our initial working proposals

15. The seven key themes set out the issues and opportunities that we seek to address and have informed our initial working proposals which we will discuss with ARs and RBs. These are set out in the table below.

Key theme	Summary of issues/opportunities and initial working proposals
Overarching purpose of the PCF approval process	<p><i>Issue/opportunity:</i> While the Rules and Guidance set out a list of criteria and evidence the LSB will take into account in our assessment, the LSB's priorities and degree of scrutiny we will give to PCF applications could be clearer in our Rules and Guidance.</p>
	<p><i>Initial working proposal:</i></p>

	<p>We will set out some principles as part of an overarching statement which will clarify the overall purpose of the PCF approval process. This will set the scene for the other key themes which will be examined through this review. The proposed principles will also inform a broader narrative which the LSB will develop on our expectations of an effective regulator and which sets out how the different strands of our work fit together.</p>
Permitted purposes	<p><i>Issue/opportunity:</i> Lack of transparency on the allocation of PCF income to permitted purposes activities. Need for clarity on whether the methodology ARs use to allocate PCF income to permitted purposes is compliant with section 51 of the Act. Neither the Rules nor Guidance address these.</p> <p><i>Initial working proposal:</i></p> <ul style="list-style-type: none"> - To ensure there is transparency of information to allow those that pay the PCF to drive accountability for the expenditure of PCF income and allow the regulated community (and the LSB) to better scrutinise spend on non-regulatory permitted purpose. - To ensure the methodology ARs use to allocate PCF income to non-regulatory permitted purposes is compliant with section 51 of the Act.
Reserve arrangements	<p><i>Issue/opportunity:</i> Lack of clarity about how ARs have determined their reserve arrangements and how much PCF income is accumulated in them. The Rules refer only to a broad obligation for ARs to give an explanation of contingency arrangements where unexpected regulatory needs arise during the PCF year and the Guidance only asks that ARs have reserves policy which ensures that an adequate level is set for the upcoming budget.</p> <p><i>Initial working proposal:</i></p> <ul style="list-style-type: none"> - ARs to set out a clear reserves policy, justification for it, the level of reserves held and that they are set at an adequate level for the upcoming budget. - ARs to ringfence reserves which contain surpluses generated directly or indirectly from PCF income or explain why it cannot.
Equality and regulatory impact assessments	<p><i>Issue/opportunity:</i> Lack of meaningful equality or regulatory impact assessments despite proposing PCF increases or changes to the PCF methodology for charging PCF, or persuasive explanations why these assessments are not necessary. Lack of meaningful consideration and information provided by ARs on equality issues, impacts on the LSB's obligation to comply with its public sector equality duty under the Equality Act 2010.</p> <p><i>Initial working proposal:</i></p> <ul style="list-style-type: none"> - An initial equality impact assessment of any differential impacts on individuals in the possession of protected characteristics as a minimum - A full equality impact assessment, if the initial equality impact assessment reveals more than a minimal impact - ARs to show clear understanding of the context in which they operate to ensure any changes or risks to the sector have been considered.
Consultation and engagement	<p><i>Issues/opportunity:</i> ARs consult annually on the PCF, but most of the PCF applications for 2019/20 show that the regulated community was not adequately engaged by ARs and the costs and benefits of regulation and what it is achieving has not been meaningfully communicated. There is also a lack of transparency around how consultation responses were considered and whether they resulted in changes to the PCF proposal. The Guidance encourages ARs to conduct regular and periodic consultation (but must consult if there is an increase in PCF or if the</p>

	<p>methodology for calculating the PCF changes) but is silent on the form, and manner of the consultation.</p> <p><i>Initial working proposal:</i></p> <ul style="list-style-type: none"> - ARs should consult if there is a PCF increase or change in methodology - Each year ARs should publish an account of what the expenditure of PCF income in the previous PCF year has achieved - ARs to demonstrate that they have taken meaningful steps to engage their regulated community, which could have a range of manifestations such as the publication of costed business plans - ARs to demonstrate how they have considered responses and any changes they have made to their proposal as a consequence or explain why they have not done so.
Addressing specific areas of improvement	<p><i>Issues/opportunities</i></p> <p>ARs regularly fail to address issues or specific points of improvement identified in previous PCF decisions despite the Guidance reinforcing the need for this.</p> <p><i>Initial working proposal:</i></p> <p>To make clear on the face of our Rules that we will be rigorous in our follow up to ensure ARs demonstrate they have addressed issues identified in the decision notice for the previous year.</p>
Interim measures to collect limited PCF	<p><i>Issues/opportunities:</i></p> <p>There have been some instances where the specific issues identified in a PCF application may have supported refusal. The existing Rules set out the process if a PCF application is refused and note that the LSB may specify the circumstances in which we would permit the AR to charge a PCF under its regulatory arrangements as an interim measure pending consideration and approval of its full application. However, neither the Rules of Guidance, specify what these circumstances are.</p> <p><i>Initial working proposal:</i></p> <p>We specify the circumstances in which the current Rules allow ARs to collect a limited PCF as an interim measure if the LSB refuse their PCF application or a component of it, pending resubmission or appeal of their application (or for example, the need for the AR to reconsult on the PCF).</p>

16. We will seek to build consensus from ARs and RBs to our approach by maintaining effective, ongoing engagement throughout the review. We will also ensure that the review focuses on potential benefits of addressing permitted purposes expenditure, not least to ensure there is a clear framework for all ARs and RBs when setting the PCF which is consistent with the Internal Governance Rules 2019².

² <https://www.legalservicesboard.org.uk/wp-content/uploads/2019/07/IGR-2019.pdf>

Next Steps

17. Subject to the Board's views, we will commence the first round of engagement with ARs and RBs in early February 2020.

Risks and mitigations	
Financial:	N/A
Legal:	We want to ensure our policy position on the allocation of PCF to permitted purposes is consistent with the Act. To this end we have already received counsel's advice and will continue to work closely with the legal team as we develop our proposals to ensure that our policy position is consistent with this.
Reputational:	By maintaining effective, ongoing engagement with stakeholders throughout the project we will manage expectations and risk. We will also ensure that we have a robust and effective communications strategy in place which communicates the purpose and scope of the review and the benefits to the regulated community.
Resource:	N/A

Annexes

Annex A

Freedom of Information Act 2000 (Fol)		
Para ref	Fol exemption and summary	Expires
None		

Annexe A

Permitted Purposes

The permitted purposes as set out in section 51 (4) of the Act are:

- a) the regulation, accreditation, education and training of applicable persons and those either holding themselves out as or wishing to become such persons, including:
 - i. the maintaining and raising of their professional standards; and
 - ii. the giving of practical support, and advice about practice management, in relation to practices carried on by such persons;
- b) the payment of a levy imposed on the approved regulator under section 173 of the Act and/or the payment of a financial penalty imposed on the approved regulator under section 37 of the Act;
- c) the participation by the approved regulator in law reform and the legislative process;
- d) the provision by applicable persons, and those either holding themselves out as or wishing to become such persons, of legal services including reserved legal services, immigration advice or immigration services to the public free of charge;
- e) the promotion of the protection by law of human rights and fundamental freedoms;
- f) the promotion of relations between the approved regulator and relevant national or international bodies, governments or the legal professions of other jurisdictions.