

LSB consultation on proposed practising fee rules

Law Society Response

October 2020



Introduction

1. The Law Society is grateful for the opportunity to respond to the Legal Services Board consultation on its proposal for new draft rules to replace the current Practising Fee Rules 2016 made under section 51 of the Legal Services Act 2007 (the Act).
2. The Society is also grateful for the opportunity to have raised its principal comments and concerns on the draft rules and guidance with the LSB with a view to seeking clarifications in advance of submitting this response.
3. This response is made on behalf of the Society as approved regulator, also performing section 51 permitted purpose representative functions. The Solicitors Regulation Authority (SRA) will respond independently as regulatory body.
4. The Society is supportive of the LSB's desire to provide further clarity and, to the extent that it is practical and proportionate, consistency across the profession. While we agree the importance of increased transparency and the benefits of an increase in the level of engagement from regulated persons, the Society also considers that the rules must first and foremost be legitimate and permissible within the Act. They should also not be disproportionate, prohibitively impractical or counter-productive.
5. Before responding to the consultation questions on the draft rules and associated guidance, the Society must raise its broader concerns.

Legality

6. The Society is concerned that, as drafted, the effect of the draft rules and guidance is to subordinate the wider permitted purposes described and permitted by Parliament to the more limited regulatory objectives. This is a fundamental change from previous and existing rules and is inconsistent with the terms of the Act.
7. The draft rules and guidance (and the requirements they impose) also appear to assume that the funding of non-regulatory permitted purpose activities from PCF income is exceptional and must be subjected to evidential requirements in advance. For example, there is the suggestion that regulatory bodies should hold and control all PCF reserves *unless* the approved regulator demonstrates why this is 'not practicable'. This again reflects a subordination of funding for non-regulatory permitted purposes above funding for regulatory permitted purposes.
8. There is also a requirement that, as a prerequisite for using PCF income for multiple purpose representative functions, an approved regulator must give a detailed explanation of the efforts to delineate funding *and* provide justification for such use of funding. This is *in addition to* the requirement to satisfy the LSB that all funding from the PCF is within scope of section 51 of the Act.

9. This preferential approach to the LSB's section 51 assessment powers is inconsistent with both the intention and the letter of the Act. The permitted purposes that may be funded from PCF income explicitly include *both* regulatory *and* non-regulatory purposes. And they are both sanctioned by Parliament. Approved regulators and the LSB both have a legitimate interest in transparency and ensuring good governance in relation to the use of funding from the PCF. And it is permitted under section 51 for the LSB to make rules about the form and manner in which applications for approval of the PCF must be made; consultation requirements; and procedures/criteria to be applied for determining whether to approve the PCF. But rules made under section 51 cannot undermine the Society's (equal) ability to undertake permissible permitted purpose work funded from PCF income or make this ability subject to an overall imprimatur of the LSB that goes beyond the permissible scope of section 51(6) of the Act or offends the prohibition against exercising functions in relation to approved regulators' representative functions under section 29 of the Act. It would fetter the Society's ability to meet the exigencies of everyday reality and meet its objectives in relation to important public interest work.

Disproportionate burden/cost and timing

10. The Society has a real concern that the draft rules would impose significant and unjustified burdens with regard to the preparation, presentation, justification and day to day management of both financial information and information about programmes of activity.
11. The LSB will be aware that the PCF has fallen in real terms over recent years and the level of the PCF as a percentage of member firms' turnover has been reduced progressively and is relatively small. This has been as a result of diligence and a collaborative approach between the Society, SRA and LSB. In defining the outcomes that the LSB is seeking to achieve, the consultation document does not identify any apparent evidence of a mischief that warrants this level of costly intervention. The Society is concerned that the scope and extent of the processes required by the draft rules would come at an increased and disproportionate cost - directly to the Society and inevitably indirectly to our members. It also comes at a time of significant disruption and financial challenge to the wider profession.
12. It is noted that the intention is to bring the draft rules into effect as soon as December 2020. In view of the Society's concerns, we propose that implementation of the draft rules must be delayed and we invite the LSB to engage with approved regulators and regulatory bodies with a view to ensuring that any changes to the rules are proportionate, reasonable, necessary, and indeed permissible. There are also practical concerns about the ability of approved regulators in such a short period of time to bring their business planning and accounting schedules in line with the scope of proposals in time to comply with the increased level of requirements and in the form that they will be required.
13. We now provide more detailed comments in response to each of the questions.

Question 1: Do you have any comments on the above draft rules 1 to 12? Do you have any comments on the associated Guidance?

14. Section B: Application and Guidance (Rules 2 to 4) sets out the requirement to comply with both the new draft rules and to have regard to the guidance. However, the Society notes that both the draft rules and guidance are silent on their subordination to the Act. The 2016 rules make this explicitly clear, where Rule 4 provides: *In the event of any inconsistency between these Rules and the provisions of the Act, the provisions of the Act prevail*. The Society seeks a similarly clear statement in any new rules and guidance.
15. Draft rule 6 is a new addition and does not appear in the current or previous rules. It provides:

The setting of the practising fee and the application to the Board for approval of that fee are regulatory functions and must be discharged in accordance with section 28 of the Act. The approved regulator must, so far as is reasonably practicable, act in a way:

 - a. which is compatible with the regulatory objectives; and*
 - b. which the approved regulator considers most appropriate for meeting those objectives.*
16. This draft rule appears to conflate the setting of the PCF under an approved regulator's regulatory arrangements with the discharge of regulatory functions as defined in the Act.
17. Since section 3 of the Act requires the LSB to discharge its functions so far as is reasonably practicable in a way which is compatible with the regulatory objectives and which the LSB considers most appropriate for the purpose of meeting those objectives, to the extent that permitted purposes proposed to be funded from PCF income are "regulatory" activities the LSB may assess whether (a) the proposed regulatory activities are justified as proportionate and (b) those regulatory activities which the LSB regards as necessary will be adequately funded by the proposed PCF arrangements.
18. However, actions regarding the pursuit of permitted non-regulatory purposes do not involve "regulatory activities". These are not "regulatory functions" as defined and the Society as approved regulator owes no statutory duty to discharge these functions by reference to the "regulatory objectives" or the principles of "proportionality" or best "regulatory" practice in section 28. Under section 51, the PCF is a fee payable under regulatory arrangements because it is required as a condition of being authorised and authorisation is a regulatory matter. However, in carrying out the substantive decision-making in setting a proposed level of PCF appropriate to fund permitted non-regulatory purposes, as the Society is permitted to do, the Society is not discharging regulatory functions for the purpose of section 28. Of course, section 29 of the Act also prohibits the LSB from interfering with representative functions.

19. Accordingly, the Society does not accept (as draft rule 6 suggests) that the setting of the PCF to fund permitted non-regulatory purposes is a 'regulatory function' to be discharged in accordance with section 28 of the Act.
20. With reference to the scope of permitted purposes, draft rule 8 is written to apply to '*applicable persons*' who are defined as including '*relevant authorised persons and any other person regulated by the approved regulator.*' However, for the specific purpose of exercising control over practising fees charged by approved regulators section 51 provides that practising fees relate to '*persons authorised to carry on one or more activities which are reserved legal activities*' and it refers to this class of persons as "*relevant authorised persons*". There is no recognition of or definition for the wider term of 'applicable persons' as used in the draft rules.
21. The Society understands that the reason for this wider definition may be to reflect the reality that PCF income is applied not only to "*relevant authorised persons*" but to all persons who are subject to an approved regulator's regulatory arrangements. However, in view of the more limited statutory definition of the class of persons in respect of whom practising fees may permissibly be charged (and approved by the LSB), it would assist the Society (and the approved regulator community more widely) if the LSB could clarify its own understanding of the basis on which the LSB is permitted to exercise rule making functions to this wider extent.
22. Draft Rule 8(b) should be amended to reflect levy payments imposed under section 173 of the Act rather than section 172.
23. Draft Rule 9(a) requires approved regulators to make application for approval of the practising fee level using the form at Annex 1 to the Guidance. The Society supports the concept of consistency which the use of a standardised form provides. However, we note that practical issues are likely to arise in producing all of the information requested in the form, specifically in respect of section III Financial information (draft rules 13, 17-18). We set out our concerns in more detail below.

Question 2: Does the overarching criteria in draft Rule E13 adequately set out the LSB's expectations of Approved Regulators when considering a practising fee application? Are there other criteria which should be included? Do you have any comments on the associated draft Guidance?

24. The Society supports the setting out of overarching criteria in draft rule 13. But we note, particularly in relation to the guidance for draft Rule 13(a) Transparency, that each approved regulator will have different levels of activity that it undertakes. While it is important to be transparent about the proposed areas of activity, it may be very difficult to set out in great detail each singular activity that is likely to be engaged in throughout the year. This is not least because, as has been experienced in the unpredictable circumstances of this current year, there is a real need for a level of flexibility and re-prioritising which takes account of unforeseen circumstances. Accordingly, the Society would welcome further clarity regarding the level of detail that would be required.

Question 3: Do you have any comments on draft rules F14 to 16? Do you have any comments on the associated draft Guidance?

25. Paragraph 63 requires that, if an approved regulator intends to apply PCF income to representative functions with multiple purposes, a detailed explanation of the efforts to delineate this funding and the justification will be required. The Society seeks clarification of the purpose and meaning of this requirement. In particular, the LSB should clarify whether (and if so, how) the requirement set out in paragraph 63 is different to the requirements already set out in paragraph 62.
26. With reference to draft rule 16 and paragraphs 62 and 63 of the guidance, the Society also seeks clarification of the basis on which the LSB considers it permissible to seek information from approved regulators in relation to representative activities that do not relate to permitted purposes under section 51 of the Act.

Section G: Financial Information (Rules 17 and 18)

27. While no comments have been invited in respect of Section G, we make the following observations in relation to Financial Information (Rules 17 to 18).
28. The draft guidance provides that *'Approved Regulators should provide an accurate presentation and representation of the LSB and Office for Legal Complaints (OLC) levies...'* However, no details are given about when and how approved regulators will be provided with this information. Further, the LSB and OLC should follow a consistent pattern for providing detailed financial information to approved regulators similar to the level of detail required from approved regulators. This would serve the objectives of Transparency and Accountability and ensure a level of consistency.
29. The Society notes that the rules are drafted to place obligations on the Society, as approved regulator, to provide specific details. However, much of the information that would be required is held by regulatory bodies. In view of changes introduced by the Internal Governance Rules restricting the ability of the Society to seek financial information from the regulatory body, the Society seeks an explicit statement in both the rules and guidance that regulatory bodies are under a duty to co-operate and provide all necessary information to approved regulators (where applicable) to ensure that approved regulators may discharge their responsibilities as set out in the rules and guidance.
30. The Society also notes that, under the Internal Governance Rules, the LSB expressly reserves to itself the ability of oversight of regulatory bodies. Consistent with this arrangement, and to ensure the effective use of time and resource, the Society seeks confirmation that the LSB will deal directly with regulatory bodies to ensure the provision of outstanding information required to be provided.

31. Draft rule 17 requires approved regulators to provide financial information for the previous year, including a comparison of actual and budgeted income and expenditure and income and expenditure forecasts (including practising fee income) for three years from and including the year for which the practising fee is to be levied. As indicated above, the Society is concerned about the ability to comply with these requirements at a practical and administrative level. As read, it appears that the LSB would be seeking details of actual expenditure relating to the previous year's application in circumstances where that year would still be current and not yet completed and the actual expenditure would not yet be known or available until conclusion of the current practising fee year.
32. The Society also notes that, in order to fully and accurately complete PCF applications, there must be reliance on the levy bodies (including the LSB) to provide relevant and necessary information. This will necessarily include their own future budgets over the next three years.

Question 4: Are draft rules H19 to 23 clear? Do you have other comments on these draft rules or comments on the associated draft Guidance?

33. The Society repeats the comments made above relating to the provision of financial information that is held by regulatory bodies and not held or controlled by approved regulators.
34. Draft rules 19 – 23 set requirements in respect of the management of reserves and in respect of the provision of information relating to reserves. The associated guidance states:
- 94. If the RB has been incorporated as a separate company, it should be that company which holds and controls the account for the PCF reserve. If not incorporated the LSB would expect there to be safeguards in place to ensure that decisions in relation to these funds are made by the Regulatory Body without undue interference from the AR.*
- 95. If the AR intends to retain any part of the PCF reserves, e.g. if allocated to an activity for a permitted purpose, the AR must state this expressly – and why it is not practicable for the Regulatory Body to control this part of the reserve.*
35. This is an example of the Society's broader concerns as set out in paragraphs 6 to 10 above. These provisions suggest that it is somehow impermissible and/or undesirable for an approved regulator to diligently manage its expenditure and build a permitted purpose reserve from its share of PCF income. They also suggest that the funding of representative permitted purpose activities from PCF reserves is equally impermissible and/or undesirable and must be subjected to strict justification requirements. This is evidenced by the requirement for a statement from the approved regulator as to why it is not practicable for the regulatory body to (also) control '*this part of the reserve*'.

36. The Society notes from the draft guidance that these requirements are intended to pursue the objective in draft rule 20 (and the LSB's obligation under section 30 of the Act and the Internal Governance Rules) to ensure that regulatory functions are not prejudiced by representative functions and that decisions relating to regulatory functions are, as far as reasonably practicable, independent. However, the Society sees no connection between that objective and the 'justification' requirements in paragraph 95 of the guidance. The Society accepts that regulatory bodies are to have an independent ability to form policy on practising fee reserves relating to *regulatory* permitted purposes and to have management control over those reserves (paragraph 93 of the guidance). However, neither the Act nor the LSB's Internal Governance Rules prohibit the use of practising fee reserves by approved regulators for *representative* permitted purposes. Neither is there anything in the Act to suggest that regulatory bodies should 'control' practising fee reserves for (regulatory) permitted purposes or that the use of such reserves for representative permitted purposes must be subject to exceptional justification.
37. The Society questions the basis for disproportionately requiring approved regulators to explain or justify '*why it is not practicable for the Regulatory Body to control this part of the reserve*'. While the LSB in its rule-making capacity has a permissible and legitimate interest in transparency of practising fee reserves, this does not extend to making rules that preclude or hamper the (equal) ability of approved regulators to hold and use such reserves for representative permitted purposes sanctioned under section 51 of the Act.
38. The Society notes that draft rule 23 purports to exclude the operation of draft rule 21 in respect of any reserves that would not be made available for the discharge of regulatory functions, but this is inconsistent with the scope of requirements in draft rule 21 relating to different types of reserves. Draft rule 21 clearly envisages that approved regulators would be required to set out a clear policy on how it sets the target for the level of *its reserves* and how it manages those reserves, and that this would include *all types of reserves*. It would also include target levels for all committed and uncommitted reserves and information about how the approved regulator will manage *any accumulated reserves*.
39. In summary, the Society considers that these draft rules go beyond the scope of permissible control over the PCF and present a real risk of potential interference with the exercise of representative functions by approved regulators in breach of the requirements of section 29 of the Act. The Society considers that the draft rules should be revised to ensure consistency and alignment with the statutory framework, recognising that permitted purpose activities funded from the PCF (including reserves) include both regulatory and representative purposes and that the Act requires approved regulators to exercise their representative functions independent from any rules made in relation to the PCF.

Question 5: Do you have any comments on draft rules I 24 and 25? Do you have any comments on the associated draft Guidance?

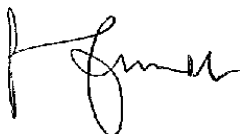
40. The Society confirms its commitment to consulting and engaging with members on matters relating to funding, strategic aims and subsequent activities. However, we acknowledge the difficulties often faced by approved regulators when consulting on practising certificate fees in generating significant engagement. The Society regularly seeks to engage with its members in a variety of ways, many of which might provide a better measure of engagement and perception of value in the work that we do. We would encourage the LSB to take into account the broad range of ways in which an approved regulator might engage with the regulated community when informing the level at which it seeks to set fees and its programme of activities.
41. We also note the importance of ensuring that the process remains as clear and transparent as can be practically expected and in line with the principle of accountability. The Society in its capacity as approved regulator receives only a proportion of the practising certificate fees. As mentioned above, a proportion of the fees collected are used to pay the levies imposed on the profession for the benefit of the LSB, OLC, Solicitors Disciplinary Tribunal and Financial Conduct Authority (for anti-money laundering purposes). When consulting with the profession, the Society believes there should be a more joined-up process with these recipient bodies to ensure clarity, transparency and accountability for the overall fees collected. For example, earlier this year the OLC proposed a 20 percent increase in its annual budget. If this proposal proceeded, it would likely have a knock-on effect on the level of practising fees to be charged.
42. We suggest that, where practicable, the LSB should engage in dialogue with levying bodies who are recipients of practising certificate fee income. It should also recognise the negative impact on effective engagement with the regulated community in circumstances where precise and adequate details from levying bodies are absent.
43. The Society also asks the LSB to provide reasonable details of its own programme of activities, its proposed levy, and other relevant information that would inform and assist the consultation process.

Question 6: Are Rules J 26 to 30 regarding initial and full impact assessments clear? Do you have any comments on the associated draft Guidance?

44. The Law Society supports the changes relating to impact assessments to be implemented through draft rules 26 to 30.

Question 7: Does the criterion set out at draft Rule K 31 adequately explain the matters which the LSB requires to be satisfied to approve a practising fee application? Are you content that the Rule on the interim collection of practising fees has been omitted from the draft rules? Do you have any comments on draft Rules K 32 and 33?

45. The current rules provide that if the LSB does not approve an application it should specify the circumstances (if any) in which the approved regulator may charge a limited practising fee as an interim measure pending consideration and approval of its full application. The Society does not agree with the omission of this contingency provision from draft rule 32. The draft guidance suggests that there should be arrangements in place for the continued operation of an approved regulator in the event that the PCF is not approved and, as a consequence, collection of fees is not possible within the intended timeframe. It also suggests that such arrangements could include reliance on uncommitted reserves.
46. This is problematic in several respects. It is both impractical and unreasonable to expect approved regulators to indefinitely fund their business and operations (for the benefit of their members and in the public interest) while a re-submitted PCF application (in full or in part) is being considered or in the event that non-approval of an application (in full or part) becomes subject to challenge with consequential delays. The Society considers that the uncertainty that is likely to arise in such circumstances would serve neither the public interest nor the interest of members of approved regulators that is envisaged to derive from section 51 permitted purposes. The Society also questions the ability of the LSB, under the scope of its rule making powers under section 51(6) and (7) the Act, to require approved regulators to resort to uncommitted reserves pending the delayed determination of a PCF application.
47. The Society would however support early and ongoing dialogue between approved regulators and the LSB in order to minimise any risk of a failed application. The Society would also encourage the LSB to take pro-active steps to ensure that applications are not unreasonably refused.
48. We trust that the LSB will find this response helpful and that it will give due consideration to the concerns raised and comments made.



Paul Tennant
Chief Executive