

Meeting: Legal Services Board

Date: 18 March 2021

Item: Paper (21) 13

Title: OLC Budget Application 2021/22

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Status: Official

Purpose of the paper

1. The Office for Legal Complaints (OLC) is required by the Legal Services Act 2007 ('the Act') to adopt a budget which is approved by the LSB. This paper provides an analysis of the submission made by the OLC for its proposed 2021/22 budget.
2. The OLC is seeking a total budget of £14,471,042, an increase of £1,662,726 (13.0%) over the current year Budget of £12,808,316. Factoring the in-year variation the Board agreed in November 2020, it represents an 8.9% increase.
3. The OLC Chair, supported by the Legal Ombudsman's Chief Ombudsman, Chief Operating Officer and Head of Finance, will attend to respond to questions.

Recommendation:

4. The Board is invited to:
 - **approve** the OLC's budget proposals
 - **authorise** the executive to seek agreement with the OLC and Ministry of Justice on an enhanced public reporting approach by the OLC on the Legal Ombudsman's operational performance
5. The justification for this recommendation is set out in paragraphs 33 to 41. Summarising, the executive considers that the decision is finely balanced, but that three reasons justify the increase. Firstly, the Legal Ombudsman's recovery is critical to the regulatory objective of promoting and protecting the interests of consumers, and to our strategic aim of stronger confidence in regulation. Secondly, the Board can have more confidence than twelve months ago that the investment would be wisely spent; this includes the OLC's increased appetite for innovation. Thirdly, the investment is necessary to give the OLC an opportunity

to address performance issues in the context of a backlog which has grown considerably in the last year in a challenging operational environment. However, recovery is not guaranteed; should the expected benefits not materialise, the Board would be justified in calling on the government to pursue alternative arrangements to deliver effective consumer redress in the sector.

Background

6. Schedule 15 to the Act requires the OLC, before the start of each financial year, to adopt an annual budget which has been approved by the LSB. The Act requires that the budget must include an indication of the distribution of resources deployed in the operation of the ombudsman scheme and the amounts of income arising or expected to arise from the operation of the scheme. In addition to these statutory criteria, under the Tripartite Operating Protocol agreement between the Ministry of Justice, the LSB and the OLC, the LSB may also set budget acceptance criteria. These criteria were finalised on 9 December 2020, see **Annex A**.
7. The budget approval process undertaken by the LSB is designed not to duplicate the work properly done by the OLC in scrutinising the basis on which the budget has been developed. Rather, the approval process is designed to provide adequate assurance to the Board of the robustness of the OLC's process in formulating its budget. The acceptance criteria provide the basis for this analysis. Further, as an independent NDPB, the OLC has its own Accounting Officer and Audit and Risk Assurance Committee. It also has an independent relationship with the Ministry of Justice in accordance with Managing Public Money. Hence, while the LSB approves the level of the budget, it does not have ongoing responsibility in relation to in-year financial control issues (unless these cause the budget to be varied) nor in relation to the propriety of spend.
8. The Board discussed the OLC's draft application at its 2 December meeting, with OLC representatives and Legal Ombudsman executive members in attendance. At the time, the OLC had indicated it was likely to seek a 19% budget increase. Against the backdrop of the troubled 2020/21 budget application, the Board welcomed the progress made around budget processes and content over the past year, as well as the allocation of more resource for impact insights and the proposed introduction of thematic reviews. However, notwithstanding this and constructive engagement throughout the budget process, the Board had reservations about the draft budget proposal, and considered that the budget increase request had not been fully justified in its current form.
9. There has been close engagement between our respective teams to ensure that we had all the information necessary to fully consider the finalised application. This includes the development by the OLC of a value for money framework, which the Board specifically requested at its December meeting. More widely, the OLC, Ministry of Justice and LSB have jointly reviewed the operation of the monthly performance dataset and discussed future arrangements for public reporting by the OLC on the Legal Ombudsman's operational performance.

10. The OLC has consulted publicly on a draft business plan and budget. The lower budget sought in its finalised application takes account of stakeholder feedback. The application also reflects the input of the new Chief Ombudsman and Chief Operating Officer who assumed their positions in January 2021.

The OLC's proposed budget

11. The OLC has provided a detailed submission providing information against each of the Board's acceptance criteria – see **Annex B**. The OLC has also provided its revised business plan as an appendix to the application – see **Annex C**.

12. The OLC is seeking a total budget of £14.471m, an increase of £1.662m (13.0%) over the current year Budget of £12.808m. The OLC emphasises a multi-year approach, with year one focused on supporting stability and recovery and year two on delivering growth and improvement. Although the OLC has indicated the need for further investment in 2022/23, while the Board can indicate its view on a direction of travel, as a legal constraint, it can only approve an annual budget for the period 2021/22.

13. The reduction from the originally proposed 19% budget increase has been primarily achieved through reducing the planned levels of recruitment in 2021/22 and reducing elements of spend from non-operational areas. As a result, the forecast trajectory of improvement is slower than in the draft application. The OLC considers that higher investment would result in faster progress, but that a 19% increase is not viable given stakeholder feedback to its consultation.

14. Table 1 below summarises the proposed split of expenditure.

Table 1 – Proposed split of expenditure

Business area	2021/22	%
Operational delivery	£8,783,999	77.3%
Policy and Impact Work	£227,146	2.0%
Corporate Functions and business support	£2,350,734	20.7%
Total staff salary expenditure	£11,361,880	100%
Total non-salary expenditure	£3,109,162	
Total revenue expenditure	£14,471,042	

Analysis of the application against the acceptance criteria

15. We consider that the OLC's application is technically sound and contains a good level of information against each of the acceptance criteria. Below we set out more detail on operational performance and other considerations that are likely to be key to the Board's decision.

Operational performance

16. A key consideration is the expected performance benefits from the investment. Table 2 below summarises the OLC's forecast performance trajectory based on its budget proposals. Note this is the OLC's minimum expected position; its modelling is based on assumptions from existing processes and ways of working. Therefore, it does not take account of the potential performance gains from pursuing innovations and alternative delivery models. This is a key factor in considering the forecast pace of improvement, bearing in mind also that the new executive team will still be taking stock of the situation. The OLC signal ambition to achieve improvements at greater pace but consider it is too early to forecast with confidence the cumulative impact of planned initiatives and innovations.
17. Reflecting the current focus of performance concerns, a headline measure is the size of the backlog – the volume of files in the Pre-Assessment Pool (PAP) before a case is accepted and given to an investigator. This underlines the emphasis on stabilisation in year one, but also indicates that a sizeable backlog will remain by the end of 2022/23. By the end of 2022/23, as a minimum, the OLC expects to reduce wait times for all case complexities by 32% and increase the number of case closures by 73%. For case closures this is from a low starting point partly due to disruptions to investigations caused by Covid-19.

Table 2 – Performance expectations

Measure	2020/21	2021/22	2022/23
Incoming cases	7,200	7,200*	-
No. files in PAP @31/3	4,943	4,696	3,609
Customer wait time in PAP (days)	277	240	186
Cases resolved	4,583	7,057	7,962

* The OLC's application does not state a figure but anticipates demand will remain constant.

18. The Board receives regular updates on the performance picture via the voluntary assurance letters sent by the OLC Chair. Clearly, the current picture is of grave concern with a backlog approaching 5,000 cases and customers experiencing average delays of nine months before their case is investigated. More positively, although the backlog is still growing this is at a slower rate. There are tentative signs of recovery, such as increases in the rate of monthly case closures. Some underlying indicators that were among the root causes of performance issues have improved, especially lower staff attrition and increased staff engagement.
19. The OLC's application notes plans to support staff to increase performance and productivity, including addressing variations in performance and using examples of best practice and performance. Since this is such a key issue, the Board may wish to explore with the OLC its overriding philosophy for improving performance and how "proactively managing performance" will translate into action.
20. The Board has consistently stressed the need for OLC to innovate and explore alternative delivery models. We have emphasised that we stand ready to assist in these endeavours, for example through our statutory function to consent to

proposed changes to scheme rules. The OLC's business plan indicates that it will review the scheme rules in 2021/22. Pages 14 to 17 of the OLC's submission detail a range of innovations and alternative delivery models which it plans to either explore, pilot or is already committed to implement. Further, in their early conversations with us, the Chief Ombudsman and Chief Operating Officer have identified cultural factors that if addressed could promote more innovation plus opportunities to make some quick wins by reviewing operational processes.

21. The Board should also consider the possible negative impacts on performance if it does not approve the budget. The OLC indicates there could more than 6,000 files in the PAP in the case of another standstill budget, and that the budget sought would deliver 15% more case closures than under a standstill budget.

Other considerations

22. The paragraphs below set out a series of issues that the Board might explore with the OLC at the meeting and reflect in its decision letter, although none are considered grounds alone to reject the OLC's application.
23. As requested by the Board, pages 23 to 25 of the OLC's application proposes a value for money framework based on the 4E's model (economy, efficiency, effectiveness, equity) used by the National Audit Office and other public sector bodies. The framework is populated by a range of KPIs and other data already provided to LSB in the monthly common dataset; this includes the existing unit cost measurement. Our assessment is that there are advantages in using an established framework that considers a range of measures in the round. The operational performance metrics cover the main issues, but metrics in relation to the impact strand and EDI need further development (as the OLC acknowledges in its application). We also consider that the RAG rating should be based on objective criteria so far as possible, although this will not always be appropriate.
24. Pages 26 to 27 of the OLC's application address the LSB's acceptance criterion on EDI. It is encouraging to see an increasingly strong EDI focus on customers and staff, including measuring disproportionality of outcomes. The Board may wish to explore the OLC's long-term plans to consider EDI issues in relation to service providers. For example, law firms managed by women and people from BAME backgrounds may face issues, such as greater numbers of unmeritorious complaints or difficulties with handling complaints, which could be addressed in part through the Legal Ombudsman's policy and impact work.
25. The OLC's application acknowledges that the Legal Ombudsman does not yet have a long-term demand forecasting model. While forecasting demand will always be an imprecise science, especially as the market is in an accelerated state of flux, we see scope to employ a more systematic approach in future.
26. The OLC's application includes a Celebrating Success reward and recognition proposal of £100,000 (the same as the current year's budget). We estimate this equates to an average of £374 for every member of staff (based on 267.7 FTE). While we do not doubt that some Legal Ombudsman staff are performing well

and merit reward and recognition, the overall budget seems high in the context of the current performance picture. The Board will recall that it previously raised this issue when considering the OLC's 2020/21 in-year budget variation request. The OLC maintains that the scheme is an important part of its pay strategy, although it plans a full review of the scheme in 2021/22.

27. The OLC is seeking a higher investment than in previous years for its policy and impact work (analysis and feedback to the sector learnings from handling complaints). This is welcome although plans have been scaled back compared to the draft application. The OLC considers that marginal additional investment will enable the Legal Ombudsman to increase its output, profile and influence. Further, that it has sharpened focus on those areas which will have the most impact in preventing and reducing complaints in the first instance. Since impact work should reduce volumes of complaints and ease pressure on the Legal Ombudsman, underinvestment is likely to be a false economy. While the OLC must prioritise performance recovery this has been the case for many years, with the result that there has been consistent underinvestment in its vital impact work. The Board should satisfy itself that the OLC is pursuing this aspect of its work strategically and that the budget is sufficient to deliver the potential benefits.

Reserves

28. As previously noted, the OLC has considerable reserves, which far exceed the likely cost of winding down the organisation (a useful benchmark in assessing the prudence of reserves). However, OLC do need a significant portion of these cash reserves to fund their operational activities before the levy income is received at the end of each financial year. Should access to reserves be possible, this would not change the need for the Board to assess the budget application on its merits against the acceptance criteria. Yet, in the context of Covid-19, if the OLC could access its reserves this would enable it to fund its transformation programme without adding to financial pressures on the sector.
29. The OLC's application states that it has sought to clarify whether and how it can access some or all its reserves. The Ministry of Justice has indicated that government accounting rules around the annual allocation of income and expenditure budgets from the Treasury mean that the funding of OLC activity from their cash reserves is not viable without breaching the OLC's financial obligations.

Ministry of Justice

30. The Act requires the Secretary of State to approve the leviable amount, which covers the majority of the OLC's budget, as well as any changes to case fees. The Secretary of State also approves any amount given as grant in aid.
31. The revised tripartite operating protocol sets out a process to mitigate the risk that the Ministry of Justice or LSB might approve the OLC budget but the other does not. The LSB must approach the budget from the point of view of its

statutory responsibilities and that does not engage a view on the public finances more broadly. The OLC's application confirms that it submitted its medium-term financial plan (MTFP), including the following year's budget, to the department's requirements; the protocol dictates the MTFP must reflect the LSB's acceptance criteria. The protocol also sets out that the Ministry of Justice may provide any further comment or feedback to the OLC during its consultation period.

32. We will provide an oral update with any feedback from the Ministry of Justice.

Overall assessment

33. At the December meeting, the Board reiterated that there remained strong support from the LSB for the OLC to have the resources required to succeed. That extends to support for funding increases where the case is made out clearly. The scale of the challenge facing the OLC is even greater than a year ago (in particular, the size of the backlog has doubled over the last 12 months), in the context of Covid-19 adding to operational challenges. The executive considers that additional resources are required to give the OLC the opportunity to succeed. However, even under new board and executive leadership, there remains a possibility that the considerable challenges it faces cannot be overcome within a reasonable timeframe. In this context, our draft strategy for the sector suggests alternatives to the current model must be contemplated as a last resort, if it becomes evident that the Legal Ombudsman cannot improve.

34. The OLC is in a very different position to twelve months ago when the Board had to contemplate rejecting the 2020/21 budget application.¹ In particular:

- Leadership – the new OLC Chair has impressed and recruited new senior executive leaders with strong credentials
- Governance – a thorough lessons learned exercise was undertaken following last year's budget application and the benefits of stronger governance and project management are apparent in this application
- Engagement – the OLC has taken account of stakeholder concern in its finalised application and responded positively to the Board's feedback in December, for example by proposing a value for money framework. There has been positive executive-level engagement throughout the process
- Modelling – the work of the OLC Performance and Quality Task and Finish Group should give the Board more confidence in the assumptions which underpin the budget application
- Innovation – there is a much stronger appetite to pursue innovations and alternative delivery models that could make a step-change in performance – see paragraph 20 above

¹ The OLC representatives withdrew the application at the Board meeting and requested a standstill budget.

35. Even so, we consider that the Board's decision is still finely balanced. The OLC is still seeking a significant injection in budget for performance improvement that (on some metrics) it does not anticipate becoming evident until 2022/23. As set out in the December paper (Paper (20) 58), the dilemma is that the performance situation has created a lack of confidence in the scheme, but without the resources necessary to offer the opportunity for sustainable recovery the sector will have to accept less progress at a slower pace than is desirable. Moreover, without more funding, there is a risk that the performance situation may further deteriorate and create a situation from which it may be impossible to recover.
36. The Board's acceptance criteria include OLC's handling of stakeholder feedback. While the profession appreciated the OLC's listening approach, ultimately it was unconvinced by the OLC's proposals and stressed the financial pressures facing the sector due to Covid-19. The OLC has responded to the specific feedback by reducing the overall quantum and adjusting its approach: it is reducing planned levels of recruitment and seeking to maximise improvements that can be made with existing resources and by reviewing operational processes. It commits to establishing a stakeholder Advisory Group from April 2021 and undertaking a mid-year stocktake of progress against the Business Plan by November 2021.
37. While mindful of current financial pressures because of the pandemic, the actual additional average financial impact on professionals would be relatively modest. In affordability terms, we estimate that total levy income would represent £73 per authorised person (an increase of £5 on the 2020/21 figures) and the impact on the levy would not be felt until March 2022.² There is also a tendency for some in the sector to see these issues as the OLC's problem, rather than there being a shared responsibility for finding solutions. These solutions must include activity by regulators and professional leaders to address poor customer service and improving complaints handling by legal services providers.
38. On balance, the executive recommends that the Board approve the OLC's budget application. We consider that the additional funds sought are necessary to give the Legal Ombudsman the opportunity to stabilise and then improve its performance, in the context of a challenging external environment. The Legal Ombudsman's recovery is critical to the regulatory objective of promoting and protecting the interests of consumers, and to our strategic aim of stronger confidence in regulation. While the investment does not guarantee recovery, we suggest that the Board can have much more confidence than a year ago that the investment will be wisely spent. However, should the expected benefits not materialise, the Board would be justified in calling on the government to pursue alternative arrangements to deliver effective consumer redress in the sector.
39. Should the Board approve the budget sought, we consider this should come with expectations of enhanced public reporting by the OLC so that stakeholders can easily see if the Legal Ombudsman's performance is improving at the forecast

² The OLC has three sources of income: the levy, case fees and other income (e.g. training courses). The level of case fee income will depend on case closures among other factors; the levy amount will vary depending on the outturn to balance the difference. The OLC estimates levy income of £13,126,352, which we divided by latest figures on numbers of authorised persons (178,639). Levy income is calculated based on three-year rolling complaint volumes per approved regulator, so the costs are not evenly distributed among authorised persons.

trajectory. We are discussing with the OLC what form this might take having regard to existing and planned performance reporting. This reporting includes new initiatives such as the mid-year stocktake and value for money framework, as well as existing measures (published data on the Legal Ombudsman website, the voluntary assurance letters and the monthly common dataset).

40. We should also expect ongoing and mid-year progress reporting to cover any impact from innovations. This is necessary because the performance forecasts for the coming year do not take account of the potential performance gains from pursuing innovations and alternative delivery models, so it is theoretically possible for the Legal Ombudsman to meet its forecasts without successfully implementing any innovations. When we come to consider next year's budget, it will be crucial to have a breakdown of any performance improvements, so we can see how much is attributable to innovations as against better performance management and increased staffing.
41. Finally, experience suggests the LSB's oversight role is not well understood by stakeholders and there is a need for improved understanding of our oversight of the OLC. There is already a high level of public reporting, for example the voluntary assurance letters are published, as is the tripartite operating protocol and memorandum of understanding, while the annual report contains a full account of our activities. Despite this, we think there is scope for us to bring together the key elements of our approach more prominently on our website and link this to the OLC's public reporting of the Legal Ombudsman's performance.

Next steps

42. The Board's decision letter, incorporating any comments of wider reflection, should be provided to the OLC as soon as possible after the meeting. The OLC is required to adopt a budget approved by the LSB by 1 April 2021.
43. We will build on early discussions to seek agreement with the OLC and Ministry of Justice on an enhanced public reporting approach by the OLC on the Legal Ombudsman's operational performance. Enhancements to the LSB's website are in train and we expect to complete this work shortly.

Annexes

- Annex A – LSB budget acceptance criteria for 2021/22
- Annex B – OLC budget application
- Annex C – OLC revised business plan

Risks and mitigations	
Financial:	OLC is required to comply with Managing Public Money requirements. The Ministry of Justice is responsible for financial oversight in year.
Legal:	[REDACTED]
Comms and engagement:	There is significant interest in the Legal Ombudsman's performance. Levy payers were critical of the original 19% proposed budget increase in the context of Covid-19; this may only partly be addressed by the lower increase now proposed. The LSB could be criticised if the performance picture does not improve, or even deteriorates, by denying the OLC the resources need to improve performance. There is a need to improve stakeholder understanding of the LSB's oversight role.
Equality and diversity:	Pages 26 to 27 of the OLC's paper describe how the budget it seeks would advance equality and diversity. See paragraph 24 of this Board paper.
Resource:	N/A

Freedom of Information Act 2000 (Fol)		
Para ref	Fol exemption and summary	Expires
Legal box	s42 – legal professional privilege	
Annex C	s22 – future publication	