# Consultation response

## Legal Services Board consultation on proposed Practising Fee Rules

5 October 2020

### Introduction

The Costs Lawyer Standards Board (CLSB) welcomes the LSB's review of its approach to considering applications for approval of practising fees under section 51 of the Legal Services Act 2007 (the Act).

The process of setting and collecting practising fees is of critical importance to regulatory and representative bodies, as well as the practitioners and firms that are subject to the fee. It is therefore important that the arrangements in place for seeking feedback and approval of each year's proposed fee from the LSB are clear and streamlined. We have found the template application form used by the LSB in recent years to be a helpful tool in clarifying expectations for applicants. The review of the underlying Rules builds on that work and has the potential to positively impact everyone involved in the process. We hope this consultation response will assist the LSB in finalising the Rules and ensuring they are workable in practice.

In responding to this consultation, we have focused on areas where we have first-hand experience of the section 51 process. We do not, for example, share services with our profession's representative body, spend income on non-permitted purposes, or earn any material level of income from sources other than the practising fee. As such, we have limited evidence to offer in relation to certain aspects of the proposed Rules, and other stakeholders will be better placed to respond to consultation questions in those areas. Against that background, we have responded to questions 2, 4, 6 and 7.

### 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 Do you have any comments on the associated draft Guidance?

We agree that it is helpful to establish overarching criteria for the determination of section 51 applications, to provide a frame of reference for decision-making and to clarify expectations. However, we note that the scope of the proposed criteria is very broad. It appears to us that aspects of the criteria reach beyond the factors that are directly relevant to the LSB's role in overseeing (rather than itself setting) the practising fee for the various legal professions.

Consider, for example, the "accountability" criterion. We can, of course, see why it is appropriate to ensure that regulators have engaged effectively with relevant authorised persons when setting the fee; this is an integral part of obtaining evidence of impact and ensuring transparency. We can also see why it might be necessary for regulators to report on how previous years' fees have been spent, to ensure regulators have used funds in the way envisaged and drive retrospective accountability. These issues are directly relevant to whether or not the proposed fee level should be approved, securing the regulator's accountability to its regulated community and the wider public.

We might also see how the requirement to "address any areas of concern raised by the [LSB]" could properly fall within the accountability criterion, if this was targeted at addressing areas of concern

about compliance with section 51 procedure. But the consultation paper states that this requirement relates to "how an Approved Regulator has addressed concern raised … in relation to the regulatory performance assessment framework during that year", and paragraph 41 of the guidance states that regulators will be "expected to address these [concerns] in the application". This appears to us to take the criterion beyond the scope and purpose of the power in section 51. There is an established statutory framework for addressing regulatory failings, as set out in sections 31 to 48 of the Act. The proposed accountability criterion would, if introduced, circumvent that framework by introducing a new – and arguably much more powerful – lever to punish poor performance, by severing a regulator's source of income. Reading Part 4 of the Act as a whole, this was clearly not the intention of parliament when enacting section 51.

The proposed "proportionality" criterion provides a further example. That criterion requires that the practising fee is adequate to "effectively" discharge the approved regulator's regulatory functions in an "efficient and cost-effective" way. There is nothing in the guidance that gives an indication as to how the LSB will determine whether the regulator is effective, or assess the efficiency and cost-effectiveness of its work.

We would see such assessment as being the role and remit of the regulatory body's board – or even its executive management team, depending on intended scope of the criterion – in ensuring that the operations of the regulator are aligned with organisational strategy, business need and the obligations in section 28 of the Act. And there is already a separate framework in place for providing assurance to the LSB on these matters. The Internal Governance Rules 2019 provide (in Rule 9) that "each approved regulator must provide such resources as are reasonably required for its regulatory functions to be efficiently and effectively discharged". The Internal Governance Rules contain standalone provisions for ensuring compliance. Again, the draft Practising Fee Rules appear to use section 51 as an enforcement vehicle for obligations that are external to the practising fee approval framework.

It is also clear from the draft Rules that this criterion will be applied to justify – in and of itself – the refusal of a section 51 application. Rule 31(d) expressly provides that a regulator must satisfy the LSB that "the fees to be allocated to regulatory functions are sufficient to effectively discharge those functions" and the guidance states (in paragraph 139) that the LSB is likely to refuse the application if the regulator has not satisfied the LSB that the practising fee complies with Rule 31(d).

Like the frontline regulators, the LSB must make regulatory interventions that are proportionate and targeted to performing its role as an oversight regulator. We share the concerns of other stakeholders that the proposed criteria in Rule E do not conform to these principles because they go beyond the scope of what is required to achieve the purpose of section 51. We would encourage the LSB to re-couch the criteria so that they are focused on ensuring that the regulators' processes for setting, collecting and spending the practising fee are transparent and fair to the regulators' stakeholders.

### 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?

Proposed rule 18 requires financial information to be provided on an accruals basis, rather than a cash basis, if reasonably practicable. At an LSB workshop on the proposed Rules, we identified a potential practical issue with this requirement and you asked us to reiterate that issue in our written consultation response. We have done so below.

Our accounting year runs from January to December, in line with our practising year. This means that we receive practising certificate fee (PCF) income for one practising year across two accounting years. The bulk of the income is received in November and December of the preceding practising year, with

income from late applications received in January of the current practising year, and then income from reinstatements and new qualifiers (i.e. in-year applications for a practising certificate) received on an ad hoc basis throughout the current practising year.

If we report our income on an accruals basis as required by the draft Rules, the LSB will receive information about how much income we generate in a financial year but not how much income we generate for the relevant practising year. That is, you will not receive data on how much income was derived from the previous year's approved PCF. This will also make a comparison of actual income against budgeted income difficult, as we set our annual budgets on neither a cash nor accruals basis, but on the basis of total income expected from the relevant year's PCF (whenever collected).

You might, therefore, gain little benefit from us reporting on an accruals basis. It is worth noting that we would not fall within the exemption in draft Rule 18, as it would still be "reasonably practicable" for us to report on an accruals basis (at least for past income, although not for future income). We understand that a number of the regulators might be in a similar position.

On this basis, there is a risk that mandating the way all regulators must report financial information will not produce the outcome you desire. Reflecting the LSB's preferences in the guidance could be a more agile approach. Either way, it would be helpful if the guidance could explain what the LSB is trying to achieve here, so that regulators can understand what would be most useful to you within the parameters of their own financial systems.

In relation to reserves, we believe that paragraph 90 of the guidance would benefit from clarification. That paragraph (the substance of which is also reflected in paragraph 103) provides that any accrued practising fee reserves in excess of the target level ought to be returned to the regulated community by a corresponding reduction in the practising fee for the following year. Presumably this does not mean that if the practising fee is £100 in year 1, and the excess reserves in year 1 equate to £1 per practitioner, then the practising fee in year 2 must be £99. We assume the intended policy position is that the excess reserves from year 1 should be applied to meet envisaged expenditure in the year 2 budget, such that the year 2 PCF – which might be £100 or £50 or £150 depending on a variety of factors – would be £1 per practitioner less than it would have been in the absence of excess reserves in year 1. If that is correct, we feel this would be better expressed by referring to a regulator using the excess reserves to offset planned expenditure in the following year rather than stating that that there must be a "corresponding reduction" in the practising fee, which could be read as mandating the level of the fee.

### 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?

We would encourage the LSB to provide more direction to regulators, either through the guidance or by the early publication of good practice examples, as to the level of detail it expects in both initial and full impact assessments. The term "impact assessment" can take a variety of meanings. The regulatory impact assessment for the Legal Services Bill, for example, ran to 81 pages of detailed analysis. The regulatory impact assessment for this consultation, by way of another example, runs to two paragraphs. This demonstrates the broad spectrum of approaches that could be taken to assessing and communicating impact. While the draft guidance provides some high level bullet points in relation to the scope of an assessment, these give only limited insight into the degree of investigation and analysis the LSB envisages.

We note that, under the government's Better Regulation Framework guidance (republished in March 2020), the threshold for a full impact assessment is a net direct cost to business of ±£5 million. Even if

we increased our practising fee by 50%, from £275 to £413, the net cost to business would be under £100,000 – or £4.9m short of the government's threshold for a full assessment. It might be that the LSB is not expecting the regulators to ever produce a full assessment of the kind undertaken within the Better Regulation Framework, but if that is the case then we would encourage the LSB to make this clear in the guidance.

The use of financial thresholds in the Better Regulation Framework guidance also highlights the risk that a blanket policy approach – mandated across all the regulators regardless of the size of their regulated community – could result in a disproportionate requirement. The relative regulatory burden of carrying out detailed impact assessments (whether initial or full) on smaller regulators – and thus the resulting financial burden on their regulated community – does not appear to have been addressed by the LSB in its review of this aspect of the Rules.

We would encourage the LSB to consider taking a risk-based approach to impact assessments, by (for example) making clear in its guidance that the scope of any impact assessment carried out by a regulator as part of a section 51 application should be proportionate to the level of potential (cumulative market) harm that the assessment is designed to address.

### 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?

We were pleased to see that the existing Rule on the interim collection of practising fees has been omitted from the draft Rules, and take reassurance from the LSB's acknowledgement that collection of an interim fee is unworkable in practice.

The proposed new solution (in draft Rule 33) is to place an obligation on regulators to put forward their own contingency plans for a refusal scenario. While it is positive that the LSB recognises that a diversity of approach across the regulators might be necessary, we are concerned that this solution gives a false sense of comfort that a refusal is a routine matter that can simply be managed through proper planning.

The draft guidance provides as follows at paragraph 140:

> "There should be arrangements in place for the continued operation of the approved regulator in the event that the practising fee is not approved and as a consequence, collection of practising fees is not possible within the intended timeframe. The arrangements could include reliance on uncommitted reserves, and/or allowing extra time when submitting the application in case it is refused, to allow for it to be resubmitted in whole or in part for approval."

The LSB's focus appears to be on a regulator having sufficient cashflow to continue operating for a few months while the issue is sorted out. While we do not purport to speak for other regulators, our understanding is that most regulators would have either sufficient reserves or sufficient operating capital to cover a short interim period. But this overlooks the significant financial, logistical and reputational impacts of a refusal decision.

For example, the logistics of moving our renewal process back in light of a refusal would be very challenging. The process subsumes the majority of one staff member's time for around six weeks and we procure additional resource for the period as well as an additional back-up server and IT support.

Our resourcing plans for the process are set well in advance, and we schedule other activity around it. Moving the process would incur significant cost and put other workstreams in jeopardy.

Another key issue is that practitioners would not hold a valid practising certificate while the issue was being resolved. This time period could be lengthy, particularly if further public consultation was required. In exploring this issue with the LSB at pre-consultation stage, there was a suggestion that we might seek to renew practising certificates but defer payment until the practising fee was approved. That approach would import real practical difficulties for us. As well as requiring a change to our Practising Rules (which we could not, of course, make unilaterally), we would also face a risk of widespread non-payment. Under normal circumstances, the incentive for practitioners to make timely payment of the PCF is the need to obtain a new practising certificate. Practising certificates are never normally issued until payment is made and, without a certificate, a practitioner's name is removed from the register at the start of the practising year. The practitioner must then apply for reinstatement if they wish to return to the register, which attracts an administrative fee.

If a practitioner is already in possession of a practising certificate, there is limited incentive to make timely payment. Threatening to revoke a practitioner's certificate if they did not pay on time would be unpalatable from a reputational perspective, given that it is likely to be perceived as the regulator's fault that payment was not collected upfront in the usual way. And if there was widespread non-payment, we could not justify a mass removal of Costs Lawyers from the register for a variety of reasons (including the public and consumer interests). The most likely outcome would be an absorption of the loss and a decrease in our operating budget. If the relevant application had been refused by the LSB because the proposed fee was considered too low, such an outcome would be particularly perverse.

We appreciate that firms might be more willing than individuals to pay on a deferred basis. However, given the timing of the practising certificate renewal process, a delay would push the payment into the next financial year. This would mean that larger firms which pay fees for multiple practitioners would incur two PCF payments in the same financial year (assuming the following year's PCF was collected under the usual timetable). As there is no reason to expect firms to have budgeted for such an occurrence, there is a real risk of firms refusing to absorb the liability – which they would be entitled to do – such that the obligation to pay would fall to individual practitioners.

There would also be tax implications for individuals if the payment was delayed by several months, depending on whether the tax relief available on the practising fee could be claimed twice in one tax year.

There has been a suggestion – including in the draft guidance – that regulatory bodies should move their internal processes earlier in the year to guard against these kinds of problems. In our view, this is untenable given the already lengthy nature of the engagement and approval process for the practising fee. Our organisation sets its budget and business plan in May/June for the following year. From an operational perspective, this is very early in the business plan cycle, making it difficult to account for successes and challenges in the current year when planning for the following year. Shifting the budget setting process even further forward would exacerbate these issues, making it less likely that regulators can produce meaningful business plans and budgets that are responsive to emerging risks and opportunities.

It is evident that many of the difficulties described above relate to timing. If a regulator is informed at the end of a section 51 application period that the application will be refused, the above problems are likely to crystallise. At that late stage, there is no prospect of "saving" the planned renewal timetable.

It seems to us, from our experience of participating in the approval process, that the most effective approach must be one of ongoing dialogue and early notice of perceived problems or issues. This kind of "early warning system" can be used to unpick any fundamental concerns the LSB might have about a regulator's proposed fee level, allowing those concerns to be addressed upfront – ideally prior to consultation – and well before the application is due to be determined.

We appreciate, of course, the need for the LSB to retain a refusal power, otherwise the statutory duty to approve would be hollow. However, in our view that power should be a tool of last resort, used only where early dialogue has failed and all other options have been explored. If the process is working effectively, the refusal power should not be needed in practice; the prospect and consequences of refusal for both the regulator and the LSB (given the public impact) should provide a sufficient incentive to drive early engagement on both sides and, thus, an acceptable outcome.

Rather than requiring regulators to put forward contingency plans for a refusal situation, we would urge the LSB to encourage this culture of early resolution through the guidance (perhaps building out the sentence in paragraph 141) and, to the extent possible, in the Rules themselves.