

The Levy: funding legal services regulation

Consultation on proposed rules to be made under Sections 173 and 174 of the Legal Services Act 2007

This consultation will close on **2 July 2009**.

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1. Executive Summary

- 1.1. The Legal Services Board (“LSB”) and Office for Legal Complaints (“OLC”) have been established to ensure the highest quality of regulation within the legal profession and legal services industry for the benefit of consumers and citizens and ultimately the profession itself. The LSB aims to work with the Approved Regulators and the profession to meet common future challenges.
- 1.2. This consultation document sets out the suggested approach and the principles that we intend to include in the draft rules for apportionment of all leviable expenditure for the establishment of the LSB and the OLC and running costs of the LSB until the end of March 2010.
- 1.3. Effective regulation must be properly resourced. Under investment in effective regulation is likely to lead to greater expense in the long run. That means that regulators should not cut corners in ensuring that they have the resources necessary to do their job, but they should aim rigorously and consistently at value for money. This latter point is particularly important in the current economic climate.
- 1.4. The costs of implementing and running the LSB will, as Parliament intended be met by the professions through the practice fees levied by the Approved Regulators and paid through a levy on those bodies to the LSB. The Legal Service Act stipulates that the Board must apportion the levy according to ‘fair principles’. We believe that these principles should be consistent with the principles of better regulation and the apportionment of the levy should therefore be transparent, accountable, proportionate, consistent and targeted.
- 1.5. We have opted to approach the apportionment of costs for the LSB and OLC separately. The work of the two bodies is very different: whereas the LSB oversees all aspects of the regulation of the profession, the OLC deals with one specific element of regulation, service complaints. The OLC also will recover a proportion of its running costs through case fees. Given the different roles of the two organisations and different statutory basis for cost recovery, there is little merit in seeking a common methodology for cost apportionment.
- 1.6. The key proposals are that:
 - by 28 February 2010 Approved Regulators should pay the LSB 70% of all establishment costs for the Board and the OLC as well as budgeted running costs for the Board up until the end of March 2010;
 - in 2010/11 a further 20% of the establishment costs for the OLC and LSB should be collected, with the remaining 10% being collected in 2011/12. This phasing should reduce the scope for variation in payment levels by Approved Regulators in each of the three financial years;

- the levy for establishment costs for the LSB and running costs for the LSB up until the end of March 2010 should be apportioned between Approved Regulators based on the proportion of authorised persons regulated each body at 1 April 2009;
 - the levy for the establishment costs for the OLC should be apportioned based on the number of service complaints, relative to the total number of service complaints against all authorised persons, which an approved regulator has received for a rolling three-year period which ends with the end of the previous calendar year, for every year in which the implementation costs are collected; and
 - Those Approved Regulators who regulate authorised persons who between them represent less than 0.1% of the total number of service complaints will not be levied.
- 1.7. We are **not** consulting on the apportionment of LSB running costs beyond March 2010 or of OLC running costs in this document. We will be issuing a separate consultation document on our suggested approach and draft rules for the levy for running costs for the LSB and OLC in early 2010. In the case of the OLC, that consultation will take account of the decisions reached on how it derives its revenue between case fees and levy funding, as well as how the levy itself will be divided.
- 1.8. We are also **not** consulting in this exercise on the overall volume of spend. This was covered in consultation on the LSB's draft business plan and the overall expenditure figures given in this document represent the Board's final decisions, which have been confirmed by Ministers.

2. Introduction

Background

- 2.1. The LSB is required by Part 7 of the Act (specifically Sections 173-175) to meet all its, and the OLC's, costs through a levy on the Approved Regulators. We will therefore make rules for all leviable expenditure, as defined in the Act, which includes relevant expenditure made by the LSB, OLC and the Lord Chancellor in respect to both implementation and ongoing running costs.
- 2.2. Part 7 of the Act allows for different parts of the levy to be payable at different rates. Accordingly, this paper will look at the broad principles for how the implementation costs for the LSB and OLC can be split between the different Approved Regulators (as defined in the Act).
- 2.3. The implementation costs of the LSB and OLC are currently being funded by the Ministry of Justice (MoJ), which will recoup these costs through the levy. Ministers gave a commitment in Parliament, through the supplement to the Regulatory Impact Assessment (RIA) to the Legal Services Bill (now enacted as the Act), that the costs of implementation would be recouped over a period of up to three years. The proposals in this paper therefore match that commitment. They also seek to spread the burden of implementation costs to minimise the period over which the profession faces charges simultaneously for both implementation and running and so reduce year-on-year variation in charge levels.

Benchmarking other sectors

- 2.4. In developing our approach, we have considered how other levies, for example for the Financial Services Authority, Ofcom, Ofgem and the Gambling Commission, operate. One approach for regulators is to attribute costs based on the size, in terms of turnover, of the regulated bodies. However, unlike other organisations which are funded by a levy, the LSB is not charging firms or individuals directly, but is instead levying their regulators. No other oversight regulator is funded through a levy and the turnover of the regulator would not be an appropriate means of attributing the costs of the LSB, as turnover is based on what the Approved Regulators choose to collect through practising fees. It could also give Approved Regulators an incentive to under-fund their own work in order to reduce the costs to their members of the work of the LSB. Therefore, we have discounted this approach.
- 2.5. In the case of ombudsman schemes there are more directly useful comparisons to be made, for example in terms of split between levy and case fees works for ongoing costs. The OLC will therefore benchmark against other schemes in devising its long-term proposals. In respect of implementation costs, the OLC levy, like that for the LSB, has to be based on the 'fair principles' outlined in Chapter 3.

LSB Business Plan

- 2.6. Our draft Business Plan, which we published in January 2009, has outlined our key deliverables in relation to the levy for the end of the financial year 2009/10, namely, to have:
- levy rules in place which meet the requirements of Section 173 of the Act to apportion the levy in accordance with ‘fair principles’;
 - a process that ensures we are able to collect the levy for the LSB, OLC and the MoJ’s implementation costs as efficiently as possible; and
 - begun work on an approach to cost benefit analysis of our individual projects, our impact on compliance costs and our overall impact on the market to ensure that our activities have a positive impact.
- 2.7. The consultation on the draft Business Plan has not led to any changes in this approach.

Structure of paper

- 2.8. Our draft proposal for the rules is set out in Chapter 8 of this consultation document. This is designed to offer a broad overview of the possible shape of the rules, rather than to be formal legislative drafting or a consultation under the terms of Section 205 of the Act.
- 2.9. Respondents are also asked to consider if there are any options which we have not considered that we should have – bearing in mind that we are only looking at the apportionment of the levy in the context of the initial costs for the LSB and OLC and that we will be consulting again on the split for ongoing running costs for both organisations.
- 2.10. Chapter 9 lists suggested questions which respondents may wish to answer.

Proposed consultation timeline

- 2.11. In our draft Business Plan, we made clear that we would work with independence and integrity, at all times being open, accessible, clear and innovative in our engagement with stakeholders.
- 2.12. We are committed to that vision. This consultation exercise is an important one. We hope that all stakeholders will produce usable evidence, ideas and comments so as to provide positive outcomes for the profession and public alike.

2.13. To that end, we intend to work to the following timetable:

Timeline	Engagement
9 April 2009	Launch consultation. Post consultation document (and an executive summary) on our website and send consultation paper to stakeholder organisations.
April /early May 2009	One-on-one meetings with stakeholders about the thrust of our proposals (leaving the detailed responses to come later in the consultation cycle). Consultation workshop(s), with focus groups dedicated to proposals for the apportionment of costs. Consultation responses published as received. We circulate a draft statutory instrument
2 July 2009	End of formal consultation period – deadline for detailed written submissions from stakeholders.
Late July/early August 2009	Publication of consultation response summary, LSB response and final draft Statutory Instrument for the consultation under Section 205 of the Act.
October 2009- November 2009	LSB submission to the Lord Chancellor on the proposed rules. Levy rules laid before Parliament as a statutory instrument (21 days).
By 28 February 2010	Levy collected – see timetabling proposals in Chapter 4.

2.14. We recognise that the timetable in the first year is compressed. We will therefore need to work with the Approved Regulators closely to ensure that what we are proposing is workable and has the minimum impact on their mechanisms for collecting the practicing certificate fee.

How to respond

- 2.15. In framing this consultation paper, we have posed specific questions on the issues that will help us to develop the rules we will make under Section 173 of the Act. We would be grateful if you would reply to those questions **only in relation to the immediate issue of recovering implementation costs.**
- 2.16. We plan to publish all responses received during our consultation period and when making a submission to us we will infer that you agree to such publication. While we are happy to discuss varying our general policy in individual cases, we have a strong presumption in favour of transparency and openness and would expect to note publicly that we had received a submission from an identified body which had withheld its consent for publication in our summary of consultation.
- 2.17. We would prefer to receive responses electronically (in Microsoft word format), but hard copy responses by post or fax are also welcome. Responses should be sent to:
Email: Consultations@LegalServicesBoard.org.uk
- Post: Cathryn Hannah
Legal Services Board
7th Floor, Victoria House
Southampton Row
London WC1B 4AD
- 2.18. As we set out above, we are also keen to engage in other ways, and we would welcome opportunities to meet stakeholders at workshop events which we propose to hold during the consultation cycle or separately.

3. Fair Principles

3.1. The Act requires the LSB to act in a way that is consistent with 'fair principles' in the allocation of costs for both the OLC and LSB. We believe that fair principles should match the principles of better regulation and as such should ensure that:

- we are **transparent** in the way we apportion the levy and apply it to our activities. Approved Regulators and authorised persons need to know what they are paying for;
- we are **accountable** to those in whose interests we regulate. We will need, through our annual reports and the rules we will make for how the Approved Regulators set practising fees, to be accountable for the outcomes we achieve through the levy. There will be no hidden costs and costs should be apportioned to Approved Regulators through a clear mechanism;
- the size of the levy and its apportionment should be **proportionate**. Its collection should not put undue administrative burdens on Approved Regulators and we will not fetter the discretion of individual Approved Regulators to decide how to recoup their share of their levy from their own regulated communities (given the different demographics and business models between different parts of the sector). Nor should its volume be a disproportionate cost to either Approved Regulators or individual Authorised Persons;
- we are **consistent** in how we apportion the levy, so that it is done in a manner that is based on common and relevant units of measurement for all Approved Regulators; and
- over time, it is increasingly **targeted** to those areas which the LSB need to oversee most intensively. We must target our data collection precisely to avoid unnecessary costs for Approved Regulators and ourselves to ensure that the levy is collected in as simple and straightforward way as possible. Over time, the apportionment of the levy and, in the case of the OLC, case fees should become increasingly responsive to the "use" of LSB and OLC resources by individual organisations and areas where work is specifically needed.

Question 1 – Can respondents see any areas where our definition of "fair principles" could be improved?

4. Timetable for collection

Introduction

- 4.1. We are committed to ensuring that the Approved Regulators are aware of the costs that they need to pay early enough so that they can incorporate those costs into their planning cycles for raising practising fees. A clear approach to the collection of the levy will help the Approved Regulators to manage their administrative processes.
- 4.2. We will discuss the detailed financial mechanics of how the levy will operate and the transfer of funds between the Approved Regulators and the LSB with Approved Regulators individually. We will then document these arrangements in the Memoranda of Understanding (MoUs) between the different organisations and the LSB.

Question 2 - Are respondents content that the detailed mechanisms for the collection of the levy are detailed in individual Memoranda of Understanding between the Approved Regulators and the LSB? What might such memoranda most usefully contain?

Timetabling issues

- 4.3. We are consulting on a timetable that takes into account the fact that the majority of Approved Regulators work in calendar years, rather than the financial years aligned to the public sector cycle. We therefore believe that it makes sense to **levy to the end of the financial year ending 31 March**. We will therefore be able to set the levy based on our business plan and will not have to set our budget too far in advance; this will increase its accuracy. In accordance with the timetable for consultation set out in Chapter 2, we would therefore seek to recover the costs for 2009/10 by 28 February 2010.
- 4.4. This would mean that in future years the timetable would be as follows:
 - December - February** – Consultation on the Business plan and overall budget;
 - End February - May** - Consultation on the specific rules for the split of costs and apportionment;
 - June - July** – Decisions on level of levy in light of consultation. Clearance with Lord Chancellor and statutory instrument on the precise split laid;
 - September - January** – Approved Regulators collect levy through practice fee mechanisms; and
 - January - February** - funds received by the LSB.

Question 3 - We would welcome comments from Approved Regulators on the timetable for the first year

Question 4 – Are there other options in terms of timetabling we should consider?

Budgeting issues

4.5. The timetable we are working to would mean that we would seek to collect the following sums:

January to February 2010 – we would collect:

- **a proportion of implementation costs for LSB and OLC**
 - It is for the MoJ to determine the length of time over which implementation costs will be recovered. Based on the Ministerial commitment as the Bill was going through Parliament, our assumption is that this will be for three years.

This means that the MoJ will not recoup the full costs of implementation for three years and could decide that the Approved Regulators should bear the cost of capital recharge, which is currently set by the Treasury at 3.5% charged on the average balance in the year.
 - We anticipate recovering a higher percentage of implementation costs in the first year, as Approved Regulators would at this stage have to only three months' running costs for the LSB and will not be paying any running costs for the OLC. This option would mean that, when the running costs of the OLC start to be recouped there is not such a burden on Approved Regulators for the continued payment of implementation costs. **We therefore propose that the costs should be split 70% in the first year, 20% in the second year and 10 % in the third year.**
 - We recognise that the OLC may not have incurred costs equal to 70% of its implementation costs by March 2010. However, this proposal spreads costs for Approved Regulators over the first three years without too high a percentage of implementation costs being charged with running costs in any one year.
- **January to March 2010 running costs for the LSB.** Implementation costs are defined as the costs for the LSB until the date all its powers are conferred. The LSB anticipates that this will be at the end of December 2009 and therefore, it will incur running costs for the last quarter of 2009/10 which will need to be met by the January-February 2010 levy.

January to February 2011 –we would collect:

- 20% of the implementation costs of the LSB and the OLC;
- running costs for the LSB April 2010 to March 2011; and

- that element of running costs for the OLC not recouped by case fees from the point in 2010 at which it begins to operate.

January to February 2012 – we would collect:

- 10% of implementation costs for the LSB and OLC; and
- running costs for both bodies for April 2011 to March 2012.

Question 5 - We would welcome views on what timetable the implementation costs should be recovered. We propose that the costs should be split 70% in the first year, 20% in the second year and 10% in the third year. Do respondents agree with this approach to cost recovery of LSB and OLC implementation costs?

5. Levy for the costs of implementing and running the Legal Services Board

Introduction

- 5.1. There are two aspects to the levy for the LSB in 2009/10: the implementation costs and the running costs. We propose that the same mechanism is used to calculate implementation costs to the end of 2009 and running costs for the period January to March 2010. This will ensure consistency and avoid placing unnecessary burdens on the Approved Regulators by requiring them to provide a significant amount of different information in the first year. However, we will consult again on how costs will be apportioned for ongoing running costs after that date.

LSB costs (including the costs for the OLC Board)

	Implementation costs to end 2009 £000	Running costs Jan/Mar 2010 £000
On a resource basis	4741	1140
On a cash basis (As state in the Business Plan)	5113	1106
Difference	(372)	34

- 5.2. The figures previously quoted in our draft Business Plan were given in cash terms. However, MoJ has indicated that the levy will be recouped in resource terms, which has the effect of spreading the costs of the capital assets of the LSB over their workable life. This is in accordance with Treasury guidance.
- 5.3. The difference in numbers is due to capital outlay of £501k in capital expenditure less £129k depreciation in the implementation period. For January-March 2010 the difference of £34k represents depreciation charge likewise for the two following financial years (2010/11 and 2011/12).
- 5.4. Assuming that we recover 70% of the implementation costs (on a resource basis), along with the running costs for the LSB from January to March 2010, we expect to recover **£4,458,700** from the Approved Regulators by 28 February 2010. This figure is made up of £3,318,700 (70% of implementation costs) and £1,140,000 running costs.

Options

- 5.5. We have considered several options for how the costs of the LSB should be split in the short term and have assessed these approaches against the principles of better regulation.
- 5.6. We are working on the assumption that the principles we define in the statutory instrument in 2009/10 will provide the basis for the rules governing future ongoing running costs for the LSB. Once the levy rules for ongoing costs are established, our intention is that there will be a single statutory instrument, which would define the basic rules, which would not vary from year-to-year without pressing reason and a new Statutory Instrument every year, defining the precise amounts to be paid by individual regulators.

Option one - a risk based approach

- 5.7. A considerable amount of discussion took place while the Act was going through Parliament as to the levy being based on regulatory risk. As an oversight regulator, the regulatory risks that the LSB needs to focus on are the risks, likelihood and impact of problems connected with the way Approved Regulators regulate a particular profession and/or reserved activity.
- 5.8. In order to adopt an approach based on regulatory risk, the LSB would, therefore, need to **quantify the likely detriment – in terms of both degree of severity and breadth of impact - if things went wrong in the regulation of a specific profession and/or activity**. This would involve gaining a detailed understanding of the different types of regulated legal activities which members of a particular profession participate in and how they are currently regulated. An objective assessment of how well different Approved Regulators are performing in carrying out these duties would also be needed.
- 5.9. It is not instantly clear what methodologies might best be developed in order to enable these comparative judgements to be made. Given the breadth of the Board's regulatory objectives, we do not believe that complaints numbers against authorised persons, dealt with by each of the Approved Regulators, are an adequate proxy for regulatory risk or an indication of where the relative costs of the LSB's work will lie as between different Approved Regulators.
- 5.10. In order to obtain the data needed to define the involvement of specific authorised persons in a specific area of law the LSB would, to a large degree, have to rely on the Approved Regulators generating and providing wholly new data sets to underpin the calculation. It would also need to look at different groups within the set of authorized persons an individual approved regulator regulates, since the risks could vary significantly within different groups. For example, it might be argued that a failure to regulate a smaller high street legal firm could pose a greater risk than a failure to regulate a major City law firm, as a consumer of a high street firm may have less bargaining power or understanding of what they are

purchasing than sophisticated corporate clients possessing in-house General Counsel. However, a single failure in that corporate sector of the market could have catastrophic consequences for an individual company that far outweighs harm to individual consumers.

- 5.11. There is also a danger that we might create perverse incentives with an adverse impact on the regulatory objectives in identifying some parts of the profession as carrying higher levels of risk than others. To the extent that such identification has an impact on practising fee costs and recruitment patterns – and, even more importantly, consumer confidence - misplaced action could distort the legal labour market impacting on how well the public are served and having an adverse impact on access to justice.
- 5.12. It would take considerable time and a high degree of work by Approved Regulators to identify the data needed, putting a regulatory burden on them and the people they regulate. The cost of the LSB undertaking the research needed to verify the information given by Approved Regulators to determine regulatory risk in a way that could be considered objective to all Approved Regulators would also be considerable. Although we will explore the subject of regulatory risk further in developing work strands in the draft Business Plan on regulatory excellence, our current assessment is that it is not possible at this stage to define it in a way that is suitably robust and applicable to all regulators for budgetary purposes.

<p>Question 6 - Do respondents agree that there are no suitable metrics for the assessment of regulatory risk to enable it to be used as an apportionment tool for LSB costs in the short-term?</p>
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Option two - the volume of activity for LSB generated by each approved regulator

- 5.13. This approach assumes that the LSB would be focussing its work on those aspects of the profession that pose the greatest risk to consumers and therefore, that it would be able to distribute costs on an 'amount of work generated' basis. We would only be able to do this with any degree of accuracy on a retrospective basis, so that the previous year's work drives next year's apportionment.
- 5.14. It is important to note that, in fulfilling the regulatory objectives and achieving our work plan as defined in the draft business plan, the majority of the LSB's work will involve looking at the market as a whole, rather than a specific profession or activity. For example, the work in the draft Business Plan on diversity and opening up the legal market will be for the good of the profession as a whole and it would be difficult to accurately assess on whom the costs of this work should fall.
- 5.15. By virtue of the Act, the LSB will have the power to charge individual Approved Regulators for specific activities, such as rule approval or applications to regulate a new reserved legal activity. This means that should a cost fall solely on a particular approved regulator for a defined piece of work it would not have to be

recouped through the levy. However, the LSB will consider its approach to this issue carefully. The assessment of rules generated by one of the smaller regulators may, of necessity, take as long as those generated by the Law Society. But the number of authorised persons across whom such costs would be recouped would be considerably smaller and hence charging separately may arguably be disproportionate.

- 5.16. In the case of implementation costs, it is even more difficult to see a way of calculating volume of activity with any degree of accuracy in the timetable defined in Chapter 3.

Question 7 - Do respondents agree that there are no suitable metrics for the assessment of volume activity to enable it to be used as an apportionment tool for LSB costs to March 2010?

Option three – number of authorised persons regulated by the approved regulator

- 5.17. **We recommend that, in the short term, we apportion the costs of implementing and running the LSB on a per capita basis, based on the number of members of a profession who hold practising certificates or are otherwise registered to carry out reserved legal activities with an approved regulator.** We would ask for data on the number of members holding practising certificates at a **fixed date** – a common measure for all Approved Regulators. We suggest that this be 1 April 2009. Although not perfect, we believe that this is the most objective, robust and fair approach available in the short-term.
- 5.18. This option reflects the fact that, as an oversight regulator, the LSB interacts with the profession as whole and has considerable duties to that profession that are not directed at specific regulators.
- 5.19. This is a simple approach that requires a minimum amount of data collection for both the Approved Regulators and the LSB. Using this method the LSB can clearly define the costs for each approved regulator from the outset, which will enable them to adjust practising fees and their internal processes as part of their normal business planning cycles.
- 5.20. The approach meets the definition of fair principles as it is transparent and clear to all regulators, as we are following a clear methodology that does not place extensive regulatory burdens on the Approved Regulators in terms of data collection. In terms of proportionality, it takes account of the relative sizes of the regulators and uses a consistent methodology between them.
- 5.21. The table overleaf shows what the Approved Regulators would pay in 2009/10 (assuming a payment of 70% of the implementation costs), assuming the numbers of authorised persons remain the same as those quoted in the Draft Business Plan, (which were based on numbers of authorised persons in December 2008).

Regulator	Number of authorised persons¹	Percentage of the cost	Amount payable for 2009/10²
Law Society	108,407	79.90%	£3,562,501
Bar Council	15,030	11.08%	£494,024
Council for Licensed Conveyancers (CLC)	1034	0.76%	£33,886
Institute of Legal Executives	7488	5.52%	£246,120
Institute of Trade Mark Attorneys (ITMA)	844	0.62%	£27,644
Chartered Institute of Patent Attorneys (CIPA)	1782	1.31%	£58,409
Faculty Office	851	0.63%	£28,090
Association of Law Costs Draftsmen (ALCD)	248	0.18%	£8,026
Total	135,684	100%	£4,458,700³

5.22. On the above basis, should the Approved Regulators pass on the costs to their members on a per capita basis, each authorised person would pay **£32.86**.

5.23. We would not wish to preclude individual Approved Regulators choosing to apportion their share of the levy differently between different classes of their membership. We believe that it would seem sensible for Approved Regulators to recover levy costs through their overall approach to setting practice fees for different groups, rather than seeking a different methodology purely for LSB costs. But we would not seek to prescribe this: it is ultimately for the approved regulator to decide how best it can ensure that it meets its financial obligations to the LSB.⁴

Question 8- We would welcome views on the apportionment of costs based on number of authorised persons and whether 1 April is a suitable date at which numbers of authorised persons are defined?

Question 9 - Are there options other than those canvassed in this paper for the recovery of implementation costs which should be explored further?

¹ As quoted in the Draft Business Plan.

² Assuming numbers of authorised persons are the same as indicated in the Draft Business Plan.

³ Assuming that we recover 70% of the implementation costs (on a resource basis), along with the running costs for the LSB from January to March 2010, we would expect to recover **£4,458,700** from the approved regulators by 28 February 2010.

⁴ Our separate consultation document on regulatory independence and practice fees explores the criteria approved regulators may wish to consider using in apportioning practice fees more generally and the extent to which it would be helpful or appropriate for the LSB to offer guidance on the issue.

6. The levy for implementation costs for the Office for Legal Complaints

Introduction

- 6.1. The OLC is a different type of organisation from the LSB. It is therefore important that, when defining the levy for the OLC, we assess it independently from the LSB. It is also important that, in line with fair principles, the levy for the implementation costs for the OLC is apportioned in a manner that reflects cost causation.
- 6.2. We are viewing the levy for implementation costs for the OLC in isolation from the running costs. This is because the OLC will need to consult upon a case fee mechanism, as defined in Section 136 of the Act and, with the agreement of the LSB, how it should manage the split between levy and case fee income in managing its revenue. In looking at the levy for running costs, the OLC and LSB will need to be clear that the quality of data is there to make any complex system robust enough to guarantee the OLC's cash-flow. This is not something that can be done until the OLC has determined its scheme rules.
- 6.3. We will therefore consult again on proposals for the split of the running costs for the OLC between Approved Regulators. However, the recovery of implementation costs is not dependent on the OLC's scheme rules and therefore is something that can be defined now.

OLC implementation costs

- 6.4. The budgeted implementation costs for the OLC are, for the purposes of this paper, assumed to be **£15,159,000** in cash and resource terms.⁵ The restatement on a resource basis (subtracting capital and adding depreciation and cost of capital) could be lower but will NOT be greater than this estimate. Assuming that we will be collecting 70% of the implementation costs for the OLC in 2009/10, Approved Regulators would need to pay **£10,611,300** by 28 February 2010. The level of capital expenditure is yet to be determined.
- 6.5. It must also be remembered that OLC implementation costs relate to the period until the OLC takes on all its powers.

⁵ This number is based on the assumption that the OLC's budget equates to the £19.9m total implementation costs (as defined in the supplement to the Regulatory Impact Assessment that accompanied the Legal Services Act) minus the LSB implementation budget (which is £4,741,000 on a resource basis).

Options

- 6.6. As with the LSB levy, there are several options that we have considered for how the implementation costs for the OLC should be split. We have assessed these approaches against the principles of better regulation.

Option one – number of authorised persons

- 6.7. One option would be to apportion of the costs of implementing the OLC, on a per capita basis, based on the number of members of a profession who hold practising certificates, in the same way we propose to do for the LSB. We would ask for data on the number of members holding practising certificates at a fixed date – common for all Approved Regulators.
- 6.8. Based on the figures that were published in our draft Business Plan (which were based on numbers of authorised person in December 2008), this would mean that the costs would be distributed as follows for the 2009/10 financial year, assuming that the Approved Regulators would be paying 70% of the implementation costs.

<i>Regulator</i>	<i>Number of authorised persons⁶</i>	<i>Percentage of the cost</i>	<i>Amount payable for 2009/10⁷</i>
<i>Law Society</i>	108,407	79.90%	£8,478,429
<i>Bar Council</i>	15,030	11.08%	£1,175,732
<i>Council for Licensed Conveyancers (CLC)</i>	1034	0.76%	£80,646
<i>Institute of Legal Executives</i>	7488	5.52%	£585,744
<i>Institute of Trade Mark Attorneys (ITMA)</i>	844	0.62%	£65,790
<i>Chartered Institute of Patent Attorneys (CIPA)</i>	1782	1.31%	£139,008
<i>Faculty Office</i>	851	0.63%	£66,851
<i>Association of Law Costs Draftsmen (ALCD)</i>	248	0.18%	£19,100
Total	135,684	100%	£10,611,300

- 6.9. Therefore, should the Approved Regulators pass on the costs to their members on a per capita basis, each authorised person would pay **£78.21**.
- 6.10. This is a simple approach that requires a minimum amount of data collection in the first year for both the Approved Regulators and the LSB and OLC. It therefore, meets the fair principles criteria in showing accountability, being transparent and being consistent.

⁶ As quoted in the Draft Business Plan.

⁷ Assuming numbers of authorised persons are the same as indicated in the Draft Business Plan.

6.11. However, this approach takes no account of the relative number of complaints that are currently generated and the reasons behind the creation of the OLC. This does not reflect a proportionate or targeted approach. It therefore does not seem reasonable to base the implementation costs on numbers of authorised persons.

Question 10 - Do respondents agree that apportionment based on numbers of authorised persons in relation to OLC costs does not fit the fairness principles set out in Chapter 3?

Option two- number of complaints about authorised persons regulated by each Approved Regulator

6.12. **We recommend that implementation costs for the OLC are apportioned based according to number of complaints Approved Regulators have received about authorised persons for a rolling three-year period, for every year in which the implementation costs are collected. We would not propose to charge those bodies whose members generate less than 0.1% of complaints numbers in total.**

6.13. This is a simple approach that requires a minimum amount of data collection for Approved Regulators, since they already hold data on the number of complaints against authorised persons that they deal with.

6.14. A service complaint is defined as one in which the consumer requires redress. The complaint may be purely about service or it may also have a disciplinary element – the key point is that the numbers provided must relate to the category of cases which the OLC will in future be able to resolve (whether in whole or part). Approved Regulators will be required to objectively demonstrate the criteria by which they separate past service from conduct complaints if they do not currently do so or the total number of complaints for the three year period will be used.

6.15. The table overleaf is based on the figures provided to us by the Approved Regulators. Those Approved Regulators who represent less than 0.1% of the complaints have not been included in the table.

Regulator	Average number of service complaints 2006-2008	Percentage of cost	Amount due in 2009/10
<i>Law Society</i>	14,093	95.2%	£10,101,958
<i>Bar Council</i>	465	3.1%	£350,172
<i>Council for Licensed Conveyancers (CLC)</i>	223 ⁸	1.5%	£159,170
Totals	14781	100%	£10,611,300

⁸ This is based on our assumption that approximately 10% of the complaints that the CLC deals with are solely disciplinary (and therefore not relevant). This number will need to be verified with the CLC.

6.16. This approach is also proportionate and targeted as those responsible for the majority of complaints will be responsible for the costs of the setting-up of the new complaints handling mechanism. It provides incentives to Approved Regulators to encourage firms or authorised persons to deal with complaints better in-house and therefore reduce the cost burden associated with the OLC. It is also a consistent mechanism that is proportionate, as it reflects the way complaints are handled at the point of implementation.

Question 11 - We would welcome views on the suggested approach for collection of implementation costs for the OLC based on the number of complaints?

Question 12 - Are there options other than those canvassed in this paper which should be explored further for the apportioning of the implementation costs of OLC?

7. Next Steps

- 7.1. This consultation document sets out the suggested approach and principles that we intend to include in the draft rules for apportionment of all leviable expenditure for the establishment of the LSB and the OLC and running costs for the OLC until the end of March 2010.
- 7.2. We are **not** consulting on the apportionment of LSB running costs beyond March 2010, nor any of the OLC running costs in this document. We will be issuing a separate consultation document on our suggested approach and draft rules for the levy for the running costs for the LSB and OLC later in 2009. In the case of the OLC, that consultation will take account of the need to reach decisions on how it proposes to divide its revenue between case fees and levy funding, as well as how the levy itself will be divided.
- 7.3. However, we would also welcome views at this stage on how far the current proposals for implementation costs meet the ongoing needs of the organisations. We would be pleased to receive comments on this issue so that we may build them into future policy thinking. Where stakeholders offer such comments, it would be helpful to have as much detail as possible – e.g. as discussed above, if “regulatory risk” is suggested as a criterion for levy allocation, we would welcome detailed comment on how to define it in a suitably robust manner.

Question 13 - We would welcome views on possible different approaches that might be adopted for the medium term?

Question 14 – Are respondents content with the proposed longer-term timetable for collection, set out in Chapter 3?

8. Draft proposals for the levy rules

- 8.1. The following draft rules represent the basic content for the rules we propose to lay in October 2009. We will look to produce a draft Statutory Instrument in May 2009 that turns these proposals into the formal rules. We will then consult under Section 205 of the Act on the final wording of the rules over the summer months ahead of formally laying them. However, subject to consultation we do not envisage substantial alteration to the content.
- 8.2. In addition to the rules defined below, there will be Memoranda of Understanding between each approved regulator and the Board detailing the mechanism which will be used for the collection of the levy.
- 8.3. The Board will be required annually to update these memoranda by 1 October of each financial year to include the amount due for payment under the rules by the approved regulator, based on the method of calculation defined in the rules.

Proposal for Rule 1 - General

- (1) In discharging its functions under Section 173 of the Legal Services Act 2007, the Board will act in a way that is consistent with the 'fair principles' of being transparent, accountable, proportionate, consistent and targeted.
- (2) These rules apply to each approved regulator for all leviable expenditure for the establishment of the Legal Services Board (the "Board") and the Office for Legal Complaints (the "OLC") and running costs for the Board to end of financial year 2009/10.
- (3) For the purposes of these rules, an authorised person is a person holding, on a date specified by the Board a valid practising certificate issued by an approved regulator or is registered to carry out reserved legal activities by an approved regulator on a date specified by the Board.

Proposal for Rule 2 – Payment

- (1) The Board shall notify the Approved Regulators no later than 1 October of the relevant financial year (1 April to 31 March) of the exact amount which they will need to pay.
- (2) The levy will be due no later than 28 February of the relevant financial year (1 April to 31 March) in relation to which costs are being levied.

Proposal for Rule 3 - the timetable for recovery of costs

- (1) By 28 February 2010 Approved Regulators will pay the Board a levy representing:
 - (a) 70% of all establishment costs for the Board;
 - (b) 70% of all establishment costs for the OLC; and
 - (c) The budgeted running costs for the Board up until the end of March 2010.
- (2) Those establishment costs for the Board not included in rule 3(1)(a) will be recovered over a further 2 year period, with:
 - (a) the figure representing 20% of total establishment costs for the Board and the OLC due by 28 February 2011; and
 - (b) the figure representing 10% of total establishment costs for the Board and the OLC due by 28 February 2012.
- (3) Those establishment costs for the OLC not included in rule 3(1)(b) will be recovered over a further 2 year period, with:
 - (a) 20% beginning recouped by 28 February 2011; and
 - (b) 10% being recouped by 28 February 2012.

Proposal for Rule 4 - apportionment of the levy for the Board

- (1) The levy for those costs defined in Rule 3(1)(a) and (c) is to be apportioned between the Approved Regulators according to the principle that the proportion to be paid by an approved regulator is to be equal to the proportion which that regulator regulates of all authorised persons.
- (2) Those costs defined in Rule 3(2)(a) shall be apportioned based on the proportion to be paid by an approved regulator is to be equal to the proportion which that regulator regulates of all authorised persons as of 1 April 2010.
- (3) Those costs defined in Rule 3(2)(b) shall be apportioned based on the proportion to be paid by an approved regulator is to be equal to the proportion which that regulator regulates of all authorised persons as of 1 April 2011.
- (4) The Approved Regulators will be required to supply the Board with the data on the number of authorised persons, by 30 April of the year to which the data relates. This data will need to be in a form that can easily be verified by an independent auditor.

Proposal for Rule 5 - apportionment of the levy for the OLC

- (1) The levy for those costs defined in Rule 3 (1) (b) shall be apportioned based on the number of service complaints, as a proportion of the total number of service complaints against all authorised persons, which an approved regulator has received about authorised persons they regulate in the period from 1 January 2006 to 31 December 2008. Those Approved Regulators who regulated authorised persons who generated less than 0.1% of all the complaints generated within the period 1 January 2006 to 31 December 2008, will not be levied.

- (2) The levy for those costs defined in Rule 3 (3) (a) shall be apportioned based on the number of services complaints, as a proportion of the total number of service complaints against all authorised persons, which an approved regulator has received against authorised persons they regulate in the period from 1 January 2007 to 31 December 2009. Those Approved Regulators who regulate authorised persons who generated less than 0.1% of all the complaints generated within the period 1 January 2007 to 31 December 2009, will not be levied.
- (3) The levy for those costs defined in Rule 3(3)(b) shall be apportioned based on the number of services complaints, as a proportion of the total number of service complaints against all authorised persons, which an approved regulator has received about authorised persons they regulate in the period from 1 January 2008 to 31 December 2010. Those Approved Regulators who regulated authorised persons who generated less than 0.1% of all the complaints generated with in the period 1 January 2008 to 31 December 2010, will not be levied.
- (4) For the purpose of the levy a complaint will be defined as a complaint in whole or in part about the service of an authorised person in which the complainant is seeking redress.
- (5) The Approved Regulators will be required to supply the Board with the data on the number of service complaints, by 30 April of the financial year to which the data relates. This data will need to be in a form that can be easily verified by an independent auditor.

9. Specific questions for consultation

- 9.1. The following list of questions is not exhaustive and we would welcome comments from respondents on areas which we may not have considered.

General

Question 1 – Can respondents see any areas where our definition of “fair principles” could be improved?

Question 2 – Are respondents content that the detailed mechanisms for the collection of the levy are detailed in individual Memoranda of Understanding between the Approved Regulators and the LSB? What might such memoranda most usefully contain?

Timetabling

Question 3 - We would welcome comments from Approved Regulators on whether this timetable we propose is achievable for the first year?

Question 4 – are there other options in terms of timetabling we should be considering?

Question 5 - We would welcome views on what timetable the costs should be recovered. We propose that the costs should be split 70% in the first year, 20% in the second year and 10% in the third year. Do respondents agree with this approach to cost recovery of LSB and OLC implementation costs?

LSB Levy for implementation and running costs until the end of March 2010

Question 6 - Do respondents agree that there are no suitable metrics for the assessment of regulatory risk to enable it to be used as an apportionment tool for LSB costs in the short-term?

Question 7 - Do respondents agree that there are no suitable metrics for the assessment of volume activity to enable it to be used as an apportionment tool for LSB costs in the short-term?

Question 8- We would welcome views on the apportionment of costs based on number of authorised persons and whether 1 April is a suitable date at which numbers of authorised persons are defined?

Question 9- Are there options other than those canvassed in this paper for the recovery of implementation costs which should be explored further?

OLC levy for implementation costs

Question 10 - Do respondents agree that apportionment based on numbers of authorised persons in relation to OLC costs does not fit the fairness principles set out in Chapter 3?

Question 11 - We would welcome views on the suggested approach for collection of implementation costs for the OLC based on the number of complaints?

Question 12 - Are there options other than those canvassed in this paper which should be explored further for the apportioning of implementation costs for the OLC?

Longer – Term Options

Question 13 - We would welcome views on possible different approaches that might be adopted for the medium term?

Question 14 – Are respondents content with the proposed longer-term timetable for collection, set out in Chapter 3?

10. Impact Assessment

Introduction

- 10.1. Clearly those directly impacted by the levy will be the Approved Regulators and those in the future who choose to be Approved Regulators or licensing authorities for Alternative Business Structures. Accordingly in our Business Plan we established our commitment to consult on our proposals for the levy in early 2009/10, in order that the Approved Regulators are aware of the costs that they had to face and are able to collect the required income to meet those costs.
- 10.2. However, the levy will also impact authorised persons who are regulated by Approved Regulators and, to the extent that any additional costs are not absorbed, ultimately by consumers. It is important that we work with the Approved Regulators to assess the impact of our proposals carefully. This will be an ongoing process and we intend to ensure that in assessing the impact of the levy on the profession and consumers as a whole we look at evidence and fact, not assertion or assumption.

Purpose and intended effect

- 10.3. Sections 173 and 174 of the Act require the LSB to make rules in relation to the levy on Approved Regulators for both the establishment and ongoing costs of the LSB and OLC. The levy and the fact that the profession will meet the costs of the two organisations is something that Parliament has agreed to, based on the regulatory impact assessment done at the time was going through.
- 10.4. The obligations to comply with the rules will extend to the current eight Approved Regulators recognised by the Act; and to any other bodies that might be designated in the future, from the point that they are so designated, designated by Section 173 (5) of the Act.
- 10.5. These rules cover the recouping of rules for all leviable expenditure made by the LSB, OLC and the Lord Chancellor in respect to both implementation costs and running costs for the LSB for January to March 2010.
- 10.6. As mentioned in the paper we intend to consult early in 2010 on how ongoing running costs will be apportioned between the Approved Regulators. We have established a timetable in the paper for how we consult on ongoing running costs, so that Approved Regulators are able to plan for these.

Assessing the options

- 10.7. The options in this paper have focused on how we will apportion the costs between the different Approved Regulators. We have not, as is customary in consultation documents, considered a do nothing option. The decision to levy has been discussed in consultation documents, independent reviews, White Papers

and parliamentary debates. Following this lengthy scrutiny, the Legal Services Act 2007 came about, which requires us to apportion the levy between the Approved Regulators and therefore, **it is not an option to do nothing**.

- 10.8. This consultation has a defined set of proposals, in which we have explained why we are proposing what we are, how it fits with the definition of ‘fair principles’, defined in Chapter 3 and our methodology for collection. As mentioned in Chapter 3, consistent with the Act, and the principles of better regulation, we are committed to apportioning the levy in a way that is transparent, accountable, proportionate, consistent and targeted. We are confident that what we are proposing for both the levy for the LSB and OLC are consistent with these principles.
- 10.9. However, we recognise that, in acting in a way that is consistent with fair principles, it is theoretically possible that we could inadvertently act in a way that is not consistent with the regulatory objectives and therefore does not:
- protect and promote the public interest;
 - support the constitutional principle of the rule of law;
 - improve access to justice;
 - protect and promote the interest of consumers;
 - promote competition in the provision of legal services;
 - encourage an independent, strong, diverse and effective legal profession;
 - increase public understanding of the citizen’s legal rights and duties; or
 - promote and maintain adherence to the professional principles.
- 10.10. That said, we believe that the proposals outlined in the consultation document are consistent with the regulatory objectives and we would need evidence to determine otherwise.

Impact analysis

- 10.11. Though the levy is on Approved Regulators, not authorised persons, the Approved Regulators will need to recoup the costs from their membership, so we need to be aware of the effect of the levy on the regulated community and consumers. We have made an assessment of the impact in terms of costs we think is likely for each of the Approved Regulators and in the following Section looked at the possible implications of these costs on the Approved Regulators, authorised persons, consumers and equality and diversity issues.
- 10.12. **Approved Regulators** –it is likely that, despite the proportionate nature of the proposals for the levy, the impact of the levy for each approved regulator will be different. The systems which Approved Regulators have in place, their current financial solvency will impact on how much the levy proposals effect them. We will work with Approved Regulators to make the collection of the levy as straightforward and as easy for the Approved Regulators as possible. We are conscious of Approved Regulators’ needs and have constructed the timetable for the collection of the levy to take account of the fact that the majority of Approved Regulators work to calendar years. The fact that we have consciously sought to

align the timetable for the levy with the business planning cycles of the Approved Regulators and have proposed given them discretion on how to apportion costs to their members mean that potentially new systems and communication costs have been avoided.

10.13. Despite the work we are doing to make the levy as straightforward and as fair as possible, the levy could pose risks to the sustainability of the smaller regulators, but only if sufficient numbers of their members were to conclude that the additional costs on their practicing certificates were such as to cause them to decide to exit the profession. It is our belief that the per capita charge proposed, although it may well not be welcomed by members of the smaller bodies, will not be of a order of magnitude that is likely to have such an impact. To the extent that any significant adverse impact does occur, our final business plan notes the representations that have been put to us about the desirability of improving consumer protection by ensuring more effective protection of title for the smaller regulators. We would considering advancing that work to make sure that consumer protection was not jeopardised, either by unregulated practitioners making misleading claims about their professional status or by the effectiveness of ongoing regulation being jeopardised.

10.14. However, any difficulties an Approved Regulator may have in funding the levy will not be enough alone to convince us that our proposals are in need of revising. We will need to be convinced that the difficulties in some way jeopardise the regulatory objectives or that our proposals are not in accordance with 'fair principles' and therefore the approved regulator in question could not be expected to pay the amount we propose.

10.15. **Effect on authorised persons** - as mentioned in the impact assessment for the work on regulatory independence, unlike the Law Society and Bar Council, some of the authorised persons supervised by smaller organisations are not strictly required to practise under the auspices of those organisations. So, whereas a solicitor cannot act as a solicitor otherwise than under the regulatory framework of the Law Society, a patent attorney, trademark attorney or costs lawyer could give advice in their respective fields without formally coming under any regulatory regime. The only requirement for regulation comes when the practitioner provides reserved legal services – and on a significant number of occasions, no such services need be given.

10.16. Therefore, if the costs passed on by smaller Approved Regulators, due to the levy seem to the respective regulated communities to be disproportionate, it could be contended that some of their members may leave and practice outside the regulatory net. That means the Approved Regulators will lose membership fee/practising certificate income. It also means that consumers may ultimately find themselves without recourse to regulatory remedies in certain cases.

10.17. We do not believe that the costs we are talking about in terms of the levy are significant enough for this to be the case. For the majority of authorised persons, regulated by the smaller regulators, they will not have any of the costs for the

implementation of the OLC passed on, as the complaints numbers in their profession are not high enough to warrant it. This means that all the Approved Regulators would need to pass on is the cost of the LSB, which on a per capita basis works out at **£32.86** per annum.

- 10.18. **Consumer impact** – the levy should not put a burden on the profession which would result in extra costs being passed on to the consumer. We do not believe that the costs here would mean that the profession would need to increase costs.
- 10.19. Linking in with the points raised in terms of authorised persons, the risk that certain professionals may as a result of the levy choose not to be regulated is one we are aware of. There are undoubtedly reputational benefits from being regulated for firms or authorised persons and we would therefore be surprised if the costs of the levy were felt to in be sufficient for these to be lost.
- 10.20. If lawyers are no longer regulated, consumers may not be able to get redress through the OLC where things go wrong. Nor would any mechanism necessarily be present to ensure appropriate standards are maintained in client care or in the substance of the legal advice provided. However, we believe that the costs and greater uncertainty to the profession of more formal legally based dispute resolution will offset any perceived financial advantage of being outside the competence of the Ombudsman scheme and hence the actual threats to consumers are relatively limited.
- 10.21. **Equality impact** – ensuring a diverse legal profession is one of the regulatory objectives and therefore, something we will need to take account of in all our proposals, including the levy. Our initial assessment is that the impact on equality and diversity issues, given the sums of money involved, appear to be low. However, as a wide generalisation, the small regulators tend to have a higher proportion of lower earners than the larger bodies and it is therefore possible that lawyers from at this end of the profession could move out of the regulated sphere.
- 10.22. Therefore we would be interested to see evidence on whether the proposals have a demonstrable effect on the diversity of the legal profession and whether central action to address any such impact – e.g. through centrally determined rules on differential fee levels dependent on salary levels – would be more intrusive and expensive than the approach proposed.

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