

Meeting: LSB Board meeting

Date: 19 January 2021

Title: Finalised Practising Certificate (PCF) Rules and Guidance

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Status: Official

Introduction: Purpose of the paper/ Issue

1. This paper sets out and explains the finalised version of the new PCF Rules ('Rules') and supporting statutory Guidance ('Guidance') which we intend to publish at the end of January 2021, following the Executive's consideration and assessment of the responses received to the consultation on the PCF draft Rules and draft Guidance. The Board will recall that at the December 2020 Board, we provided an update on the consultation responses we had received and our initial views on the matters they raised. The draft decision document which includes the LSB response to the consultation responses, is provided for information.

Recommendations

2. The Board is invited to:
 - **Approve** in principle for publication (subject to any comments it may have) the final Rules and Guidance at Annex 2.
 - **Delegate approval** of any final amendments to the Rules and Guidance and the associated draft decision document at (Annex 3) to the Chief Executive.

Timing

3. Subject to the Board's approval of the attached documents, we plan to publish the Rules and Guidance after January Board, in time for Approved Regulators (ARs) and Regulatory Bodies (RBs) to plan for the 2021 PCF application cycle¹.

Background

4. The consultation sought views on the draft Rules on applications for the approval of practising fees and Guidance. Under section 51 of the Legal Services Act 2007 (the Act) the LSB must make rules specifying the permitted purposes and containing provision on the process, procedure and criteria for approval of the level of the practising fee. Under section 162 of the Act, the LSB may issue guidance on the

¹ PCF applications may be submitted at a time of the approved regulator/regulatory bodies choice, the first PCF application in the cycle is normally submitted by the Law Society/the Solicitors Regulation Authority in the month of July and the last by the Bar Council/Bar Standards Board in December.

operation of any rules made by it under the Act. The Rules and Guidance will be made pursuant to these provisions revoking and replacing the Practising Fee Rules 2016 and supporting Guidance ('current Rules and Guidance').

5. Our process for assessing PCF applications remains largely unchanged since it was first introduced in 2011. In 2019, we reviewed the PCF process and identified areas for improvement and how to better align the process with our risk-based approach to regulation which has evolved significantly since 2011. Through the review we identified the following overarching policy objectives, which are reflected in the draft Rules and draft Guidance:
 - a clear PCF application and approval framework for ARs and their RBs
 - increasing transparency about the AR's programmes of activity, and that they only apply amounts raised by PCF for one or more of the permitted purposes listed in section 51(4) of the Act
 - a clear and demonstrable link between allocation of PCF to permitted purposes activities, and for regulatory functions the regulatory objectives and the AR's regulatory performance assessment
 - five overarching criteria (on transparency, accountability, proportionality, consistency, and action targeted where needed), which ARs and their RBs must address in their PCF application
 - the requirement that ARs and their RBs set out a clear reserves policy including how reserves will be managed, held and targets
 - clear expectations on consultation and engagement, and equality and regulatory impact assessments.

Issues raised in consultation

6. The draft Rules are intended to implement our policy objectives within the boundaries of the Act, with draft Guidance on the implementation of the Rules. We were interested in respondents' views on our proposals and we received responses from all ten ARs and RBs. Although most respondents expressed support for the overall policy objectives of the draft Rules and draft Guidance, we received representations on a range of matters, some raising more significant concerns than others.
7. We have carefully considered the consultation responses, and consequently, propose changes to clarify and refine the draft Rules and draft Guidance. In particular, we have made changes in response to respondents' concerns regarding ARs' regulatory functions and representative functions in the context of the LSB's role in approving the level of the PCF. We have also taken account of respondents' submissions regarding what they consider would be increased regulatory burden on them when preparing applications and made changes where appropriate under the proposals. We do not consider that these changes detract from our core policy objectives.
8. The proposed changes we have made to the draft Rules and draft Guidance broadly fall into four categories and are detailed in the enclosed Annex 1:

- i) powers to make rules - to clarify and better align the Rules (and Guidance) with our powers to make them under the Act. This reflects that, while the setting of the PCF fee and its approval are regulatory functions, we recognise that the LSB is prohibited from exercising its approval functions in relation to representative functions that fall within the permitted purposes.
- ii) proportionality - in response to concerns raised about the burden that some of the proposals would have on ARs and RBs.
- iii) process and procedure - to clarify certain procedural aspects of the draft Rules and draft Guidance to ensure that they are workable, and
- iv) other technical changes to the draft Rules.

9. The table in Annex 1 summarises the key changes above at paragraphs 8(i). to 8(iii) proposed to the draft Rules and draft Guidance and our assessment of these. We have also made consequential drafting changes for consistency and clarity. A final version of Rules and Guidance is produced at Annex 2.

10. Some respondents also expressed the following concerns:

- i) given that the Internal Governance Rules 2019 (IGR) have empowered the independent regulatory boards and the autonomy RBs have over regulatory budgets, the draft Rules should reduce the information and analysis required for the PCF approval process
- ii) the draft rules are overly complex for smaller regulators which do not have a representative arm, in particular, requiring a breakdown of permitted purposes activities for regulatory functions is disproportionate as are the requirements on reserves, which seem to be targeted to the separation of representative and regulatory work, and therefore should only be applied to the relevant ARs and
- iii) about specific discrete issues within the draft Rules and draft Guidance.

11. We have carefully considered these responses but do not propose any changes to the draft Rules for the following reasons

- i) we consider that well-led ARs should provide the LSB with information on how their respective Boards have made a considered decision on the PCF level and the information they have based their decision-making on, as part of their PCF approval process. Assuming their respective Boards have taken into consideration the appropriate factors in their decision-making, this should not be burdensome for the ARs to provide to the LSB; and
- ii) we consider that transparency and accountability for expenditure of PCF income is as important for regulatory activities as it is for non-regulatory activities². In respect of reserves, we would expect all ARs and RBs to demonstrate that they have sufficient funds to regulate and are financially resilient irrespective of their size. Further, we

² For those smaller regulators which engage in regulatory activities only, providing a breakdown of permitted purposes activities should be straightforward.

would expect ARs and RBs to have provided the information required to their respective Boards to inform their PCF decision-making process.

12. The draft decision document which includes the LSB response to consultation responses in Annex 3, sets out our responses to these concerns more fully, as well as those referred to in iii) and includes an equality and regulatory impact assessment³.

Next steps

13. Subject to Board approval, we will publish the final Rules, Guidance to take immediate effect and in time for the PCF applications in 2021, as well as the consultation response document and individual responses.

Risks and mitigations	
Financial:	N/A
Legal:	We are proposing significant changes to the existing PCF Rules, which carries with it an inherent medium to high risk of legal challenge if implemented.
Reputational:	We have carefully considered all consultation response and articulated our responses to them in a decision document to be published alongside the final new Rules and Guidance.
Equality and Diversity:	We have conducted an equality and diversity impact assessment of the final Rules and Guidance. A summary of this is set out in the decision document which will accompany the final Rules and Guidance.
Resource:	N/A

Freedom of Information Act 2000 (Fol)		
Para ref	Fol exemption and summary	Expires
Annexes 2 and 3	Exemption section 22 (future publication)	N/A

³ As we now intend to require ARs and their RBs to only conduct a light touch regulatory impact assessment in limited circumstances (and ARs and RBs did not quantify the likely costs and anticipated benefits in their responses as we had invited them to in the consultation) our own regulatory impact assessment will reflect this approach.

Annex 1

Draft Rule/ Guidance	Consultation responses	LSB Executive assessment and proposed changes to the final Rules and Guidance
D. Legal Framework		
Rule 6	<p>Rule 6 states that “The setting of the practising fee and the application to the Board for approval of that fee are regulatory functions and must be discharged in accordance with section 28 of the Act. The approved regulator must, so far as is reasonably practicable, act in a way:</p> <ol style="list-style-type: none"> a. which is compatible with the regulatory objectives; and b. which the approved regulator considers most appropriate for meeting those objectives.” <p>One respondent argues that this appears to conflate the setting of the PCF under an approved regulator's regulatory arrangements with the discharge of regulatory functions as defined in the Act. The respondent does not accept (as draft Rule 6 suggests) that the setting of the PCF to fund permitted non-regulatory purposes is a ‘regulatory function’ to be discharged in accordance with section 28 of the Act.</p>	<p>While the <i>setting of the practising fee</i> is a regulatory function, an AR’s function to decide what representative functions it should pursue, or how much resources to allocate to those functions are not. It is simply to inform the setting of the practising fee. We recommend making minor changes to make this clearer in the Rules and Guidance.</p>
D. Procedure		
Para 30 of the draft Guidance	The LSB should state the upper time limit to be set if the 28-day decision period cannot be met.	We are sympathetic to this given that our current guidance states that we will endeavour to make a decision in 3-4 weeks. We recommend the final Guidance allows for an upper time limit of 35 calendar days with the ability to stop the clock if there is a delay in the AR/RB providing information or significant gaps in the PCF application.
E. Overarching criteria		
Draft rule 14a Transparency	<p>Rule 14 a Transparency states ‘It should be clear how the approved regulator proposes to apply the fees to a programme of activity and how the benefits of these activities will be assessed’.</p> <p>Respondents considered that this criterion goes beyond the scope of</p>	<p>We recommend further clarification to draft Rule 14 to set out that it applies to an AR’s regulatory functions not representative functions so as not to overstep section 51 i.e. that ARs are entitled to set their programme of activities that are permitted purposes which are representative functions without regard to the regulatory objectives. However, as the setting of the level of the PCF is a regulatory function this means that the LSB must consider whether the level of the fee (including such element of it as is justified by reference</p>

	<p>what is required to achieve the purpose of section 51.</p> <p>Actions regarding the pursuit of permitted non-regulatory purposes do not involve “regulatory activities”. These are not “regulatory functions” as defined and ARs do not owe a statutory duty to discharge these functions by reference to the “regulatory objectives” or the principles of “proportionality” or best “regulatory” practice in section 28 of the Act.</p>	<p>to expenditure on representative functions) is in accordance with the regulatory objectives. This will be emphasised in the Guidance.</p> <p>Consequential changes have also been proposed to Rules 14b (accountability), c (proportionality), d (Consistency) and e (targeted where action is needed) to ensure they relate to regulatory functions only. Corresponding changes to draft Guidance are also recommended.</p> <p>Changes to Rule 16 (allocation of PCF to permitted purposes) to reflect the change to Rule 14a are also recommended.</p>
Paragraph 42 of the Guidance related to draft rule 14b Accountability	<p>Guidance states that if a regulator has not undertaken the steps it needs to under the performance framework, its PCF application may be refused. This appears to take the accountability criterion in Rule 14b beyond the scope and purpose of section 51.</p>	<p>We recommend revising this content to clarify that our intent is to ensure that if a regulator has made commitments to address its unmet regulatory performance outcomes, major workstreams associated to these commitments should where possible be reflected in the regulator’s activities for the year ahead. In addition, if we have raised concerns about the capacity and capability of the regulator to carry out its regulatory function (WL2), this will be taken into account when assessing the PCF application and whether the regulator is adequately resourced. This links more closely to draft Rules 31(d) (AR must satisfy the Board that the fees to be allocated to regulatory functions are sufficient to effectively discharge those functions) and we have proposed making a consequential amendment to this draft Rule to reflect the above.</p>
<p>F. Allocation of Practising fee to permitted purposes</p>		
Draft rule 16 and paragraph 62 and 63 of the Guidance.	<p>Rule 16 sets out a requirement for ARs that where they intend to apply PCF amounts to representative functions with multiple purposes not all of which are permitted purposes, they must explain why the non-permitted purpose amount or activity cannot be delineated and provide justification for such use, in addition to satisfying the LSB that the activity to be funded is within the scope of section 51.</p> <p>One respondent considered that this exceeds the LSB’s powers to make the rules under section 51.</p>	<p>This draft Rule is intended to ensure transparency for activities which have both a permitted purpose and other (non-permitted) purpose. On reflection and consideration of the response received, we propose to reframe this Rule to focus on the need for transparency as to whether the proposed activities do or do not fall within permitted purposes rather than considering the motive behind the activity.</p> <p>Corresponding changes are proposed to the draft Guidance, including deleting paragraph 63.</p> <p>If ARs propose more than a minimal increase in the level of PCF or increase the proportion of non-regulatory permitted purposes, without an adequate explanation or transparency as to the reasons why, we will explore this during the PCF approval process, thereby holding the AR to account.</p>
<p>G. Financial information</p>		
Draft 17b	<p>The draft rule requires ARs’ to provide income and expenditure forecasts, including practising fee</p>	<p>Having reconsidered this, we propose to refine this draft Rule, to clarify that we will only expect three- year income and expenditure forecasts where the AR/RB</p>

	<p>income, for three years from and including the year for which the practising fee is to be levied.</p> <p>The LSB should provide three-year income and expenditure forecasts in line with ARs and RBs being required to under the draft Rules. Another respondent said that the LSB has not explained why it considers the provision of three years' forecasts is necessary or useful.</p>	<p>expects a material change in income and expenditure over the period (material increase in expenditure to accommodate a significant project or alternatively a cost cutting exercise). We also recommend amending the Guidance (in particular paragraphs 69 and 70) to reflect this change.</p>
Draft 18	<p>ARs are required to provide this information must be prepared on the basis of accruals rather than cash, if reasonably practicable.</p> <p>Providing this could be problematic as at the time the PCF is submitted, we are only part way through the financial year expenditure, financial year is only part way through. Actual expenditure will only be known at the end of the financial year.</p>	<p>We have stated in the draft rule 'if reasonably practicable'. We consider the submissions here have merit and on further consideration, recommend that we make provision for draft Rule 18 into the Guidance but remove from the Rules.</p>

H. Reserves

Draft rule 19, paragraph 95 of the draft Guidance	<p>Draft Rule 20 states that 'If the approved regulator has a separate regulatory body, the regulatory body should manage its own practising fee reserves as far as reasonably practicable.'</p> <p>One respondent argued that the requirement that RBs hold PCF reserves separately (as far as reasonably practicable), subordinates the funding for non-regulatory permitted purposes below funding for regulatory permitted purposes and therefore exceeds the scope of section 51 of the Act.</p>	<p>The policy aim of the draft Rule, is not to require RBs to hold their own reserves, simply that they must have no strings access to reserves and have a policy that governs the management of the reserves.</p> <p>We have reflected on this response and propose clarifying this in the Guidance. We also propose deleting paragraph 95 of the draft Guidance (which requires ARs to justify why they have retained any part of the practising fee reserves which are not for a regulatory function).</p>
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I. Impact assessment

Draft rule 25-28	<p>Conducting an initial EIA and RIA regardless of whether any increase in PCF is proposed, is disproportionate.</p> <p>Draft Rule 28 requires a full regulatory impact assessment to be carried out if one of the following conditions are met:</p>	<p>Initial EIA is mandatory and will go towards the LSB's compliance with the public sector equality duty. Further, meaningful consideration of equality issues is relevant to the regulatory objective to encourage an independent, strong, diverse and effective profession. If an adverse finding there must be a full assessment. We propose no change in the Rules.</p> <p>The impact of draft Rule 27 is that ARs/RBs will need to conduct an RIA each year. On reflection, while RIAs</p>
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	<p>The initial regulatory impact assessment finds that the practising fee may reasonably be considered likely to:</p> <ul style="list-style-type: none"> -adversely affect a significant proportion of relevant authorised persons or -be prejudicial to any of the regulatory objectives -the practising fee involves a more than minimal change in the amount payable by any relevant authorised person(s) than was payable by the practising fee of the previous year; or - A significant and unforeseen event or circumstance has arisen during the previous year which has had a substantial impact upon the conduct of legal services by relevant authorised persons. 	<p>are important for regulatory reform, we have sympathy with the ARs'/RBs' concerns that they may be disproportionate for setting the level of PCF. What will be important is to ensure that ARs and RBs take account of the impact of the PCF on the legal services market (that is the regulated profession and ultimately consumers).</p> <p>We propose deleting references to regulatory impact assessment in draft Rules 26 and deleting draft Rule 28 in its entirety and replacing it with a requirement for ARs/RBs to demonstrate that they have considered the impact of the PCF level on the legal services market and where there has been significant circumstance or event that impacts on the legal services market (e.g. Covid19). We propose to make clear in the Guidance that the depth of this assessment should be proportionate to the likely harm.</p>
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K. Decisions by the Board		
Draft rules 29-32	A number of respondents did not support the omission of current Rule 14 (d) which allows interim collection of PCF where a PCF application is refused by the LSB pending resubmission.	We recommend reinstating this in the Rules to provide greater flexibility to ARs/RBs in the event that we refuse a PCF application (Rule 31).