Moving toward a fairer fee policy

A discussion paper from the Solicitors Regulation Authority and the Law Society on how the cost of regulation should be shared

Legal Services Act: New forms of practice and regulation
Consultation paper 19

30 June 2009

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Introduction

What does the paper deal with?

1. This paper proposes the introduction in 2010 of a new structure for raising the money required annually to fund

   - the cost of regulation by the SRA,
   - the cost of those parts of the Law Society work which is properly fundable through practising fees,
   - the levy payable under the Legal Services Act (LSA) 2007 to fund the Solicitors Disciplinary Tribunal,
   - the levy payable under the LSA to fund the Law Society's share of the start-up and ongoing costs of the Legal Services Board (LSB) and the Office for Legal Complaints (OLC).

   A new structure is required to ensure that the allocation of the cost of regulation is fair in the light of firm-based regulation and the introduction of legal disciplinary practices (LDPs). The paper proposes a shift from allocating the cost only among individuals to allocating part of the cost to regulated firms.

2. The Financial Services Authority (FSA) refers to the amount that needs to be raised through periodic fees as the annual funding requirement (AFR), and we use that description in this paper to refer to the above costs.

3. Solicitors already fund most of the above activities, currently funding the Legal Complaints Service (LCS), which will be replaced by the OLC. What will be new is the start-up and ongoing costs of the LSB.

4. The second proposal in this paper relates to similar changes in relation to the way contributions are collected for the compensation fund. The compensation fund is a fund of last resort for clients who have lost money held by a solicitor, due to the solicitor's dishonesty or failure to account.

5. This consultation paper is issued by SRA and the Law Society jointly. While it is currently for the Council of the Law Society to propose the level and method of allocation of practising fees to the approving authorities, the Council expects to act on the advice of the SRA Board so far as allocation of the sums required for the SRA's regulatory work is concerned.

6. The Law Society recognises the need to make significant change to the present approach—both to reflect the move towards entity-based regulation and to achieve greater fairness overall—but the Society has not yet come to a view as to which of the detailed options it would recommend to SRA.

7. The paper deals only with mandatory regulatory fees—referred to in the LSA 2007 as "practising fees". It does not deal with voluntary (membership) fees.

8. Note: This paper does not deal with fees for 2009—but looks ahead to the fees to be paid as part of the annual renewal exercise in 2010. The SRA consulted on the firm-based fees for 2009 in November 2008—"Firm-based regulation: Fee-raising policy for 2009" (Consultation paper 12 on the Legal Services Act).[1]

9. Note: This paper does not deal with fees linked to particular applications where the fee covers the cost of the particular process.

Background

Legal Services Act (LSA) 2007

10. The LSA 2007 changed the Law Society's statutory powers to require the SRA to adopt firm-based regulation alongside the regulation of individual solicitors. All firms (partnerships, LLPs, companies and sole practices), as well as individuals will now be regulated. It also allows the SRA to regulate LDPs (firms involving different kinds of lawyers, and up to 25 per cent non-lawyers, but still providing legal services).

11. The SRA's first strategic paper on new forms of regulation and practice issued, in November 2007,[2] recognised that these developments would require a fundamental review of how the Law Society should in future raise funding from the regulated community. It proposed that, in future, less would be collected from individual solicitors through the practising certificate fee, and more would be collected from firms in private practice (i.e. recognised bodies and recognised sole practitioners).

Why change?

12. At the moment, approximately 90 per cent of the income required to support the activities of the Law Society, the SRA and the LCS is collected through practising certificate (PC) fees paid by or on behalf of individual solicitors (approximately £100 million).

13. Even without the significant developments in statutory powers, the current fee structure is far from logical in the context of modern legal practice. The amount that an organisation will pay in fees[3] to the SRA is currently based simply on the number of solicitors, registered European lawyers (RELs) and registered foreign lawyers (RFLs) seeking to obtain or renew their practising certificate. This is a simple approach, but it unfairly disadvantages some individuals and firms, as outlined in the following two paragraphs.

14. The PC fee does not apply to non-solicitor fee earners, although they earn income for a firm through legal fees, and contribute to the overall regulatory risk posed by the firm. This means that two firms providing similar legal

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[1] See www.sra.org.uk/sra/consultations/1469.article.
[2] See www.sra.org.uk/sra/consultations/338.article.
[3] It is recognised that PC fees are often paid on their behalf by the firm or organisation employing the solicitor.

services in type could pay hugely different amounts in fees simply because, for example, one firm operates with a minimum number of solicitors supervising a large number of fee-earning staff without practising certificates (e.g. paralegals, trainees), while the other operates with a much higher ratio of qualified solicitor staff, holding practising certificates. It is unfair that firms employing a lower proportion of qualified solicitors pay less towards the cost of regulation.

15. The PC fee is the same for solicitors regardless of whether they are based in private practice or within commerce and industry, or local government. This does not reflect the fact that a number of the issues give rise to regulatory cost—in particular those arising from the handling of client money—do not arise in respect of those in the employed sector.

16. Both the Law Society and the SRA believe the case for change is overwhelming. Accordingly, this paper concentrates not on whether to change the current approach—but on what is the best approach to establish a fairer fee charging structure.

Moving towards a new fee structure

Principles and objectives of any new fee structure

17. The overall objective of any fee policy is that it should be fair and coherent for all fee payers and be able to be administered as efficiently as possible, and produce a predictable level of income.

    The FSA states that its fees policy is "…not intended to give firms an incentive to be well managed [or as a practical supervisory tool]…Specifically, the periodic fee charged to an individual firm does not reflect the amount of work we may have spent on its regulation. It would be neither possible nor desirable to operate a system of 'individualised' fees on this basis across the whole regulated community..."[4]

18. We agree. Fairness in this context includes finding a simple structure which keeps the cost of administration and bureaucracy to a minimum. The question of relating costs more closely to the amount of work needed to regulate a particular firm needs to be dealt with in the context of requirements to pay "polluter pays" costs or application fees in specified circumstances.

19. We conclude that a fee policy should

    - be fair to fee payers,
    - be efficient and economical to administer,
    - ensure a predictable income to meet the costs of regulation,
    - be stable—charges should not vary considerably year on year,

[4] See www.fsa.gov.uk/pubs/policy/ps04_15_newsletter.pdf.

- be as simple as possible—to enable the regulated community to predict their likely fees,
- be based on data that can be verified,
- ensure that, where possible, the costs of particular processes that are not of general application should be borne by those making such applications on, as far as possible, a cost-recovery basis,
- take some account of ability to pay, in particular in relation to small and new businesses—fees should not be a deterrent to new entrants.

20. In addition, changes to the way that the application process is supported by underlying technology—such as a web-based applications process, which reduces the level of effort required by the profession and reduces the cost of administering this process—would be advantageous.

21. The principle that a fee policy should be fair and transparent will support our aim of promoting equality and diversity. We are currently completing a census to update our information on the profile of the profession.[5] What we do know is that black and ethnic minorities, people with disabilities and women are disproportionately represented as sole practitioners and in small firms. We hope to have a better understanding soon of the profile of solicitors in commerce and industry and local government. What we do not know is the extent to which individual solicitors in these groups or more generally have to pay for their own practising certificate or whether the cost is nearly always borne by their employers. It is difficult, therefore, to assess the extent of the equality impact of these proposals. We think that these proposals are likely to lead to a reduction in the individual practising certificate fee which may mitigate any adverse impact and could also result in a positive impact for some groups.

22. We do know that the proposals in this paper have the potential to impact differently on the various groups in the profession. The rest of the paper shows, however, that we do not yet have enough information to complete the sort of modelling that will clarify the impact. The further work to be undertaken will include an equality impact assessment which will be set out in the future more-detailed consultation referred to in paragraph 74. There will be ways in which the final structure can be adapted to mitigate negative impacts where that would be fair. We would, therefore, welcome your views on what equality impact our proposals may have on various groups in the profession.

How should the cost of regulation more fairly be allocated between individuals and firms?

23. We have concluded that the SRA's part of the AFR should be sub-divided into elements to be collected respectively from

- individual solicitors, RELs and RFLs,

[5] See www.sra.org.uk/diversitycensus.

- firms in private practice, i.e. recognised bodies and recognised sole practitioners.

24. In order to do this, we need to look broadly at the SRA's regulatory activities to see which relate primarily to individuals and which relate primarily to firms. This cannot be a scientific exercise, and must be broad brush. The SRA is moving its activities to focus more on firms, but it is probably fair to say that most of its activity, certainly on the compliance side (monitoring and enforcement activity), is already directed to firms in private practice—as opposed to all individuals holding a practising certificate.

25. The SRA has looked at each of its cost centres which represent different kinds of regulatory activity and, then, estimated what percentage of each cost centre's work deals primarily with firms in private practice, as opposed to activities which are relevant only to individual solicitors. The proposition is that, while the cost of activities relevant to individuals will be collected equally from all solicitors (including RELs and RFLs), the cost of activities primarily relevant to firms will be collected only from recognised bodies and recognised sole practitioners.

26. That exercise suggests that broadly somewhere 60–80 per cent of activity relates to firms in private practice, which suggests how the AFR could be split, at least in relation to the SRA's proportion.

Fees for non-regulatory activity

27. PC fees (and, in future, practising fees under the LSA 2007) are not required merely for the Law Society's regulatory work, carried out by the SRA. PC fees also cover work dealing with consumer complaints (presently carried out by the LCS and, in future, by the OLC) as well as work on most of the Society's non-regulatory activities.

28. Before the Access to Justice Act 1999, there were no constraints on which Law Society activities could be funded from PC fees. However, while the Access to Justice Bill was going through Parliament, the Law Society was engaged in an active campaign to draw attention to the damage to the public interest which would be caused by the Government's proposals in relation to legal aid. Consequently, amendments were made during the passage of the Access to Justice Act giving the Lord Chancellor power to restrict the non-regulatory purposes to which PC fee income could be applied.

29. In the event, regulations made under the Access to Justice Act allowed the Law Society to continue to use PC fee income for a wide range of its non-regulatory activities–particularly those where there is a clear public interest element to the activities concerned.

30. This relevant statutory provision is now contained in section 51 of the LSA. The provision provides as follows:

    s.51(4) Those rules must, in particular, provide that the following are permitted purposes –

a) the regulation, accreditation, education and training of relevant authorised persons and those wishing to become such persons, including –

   i. the maintaining and raising of their professional standards, and

   ii. the giving of practical support and advice about practice management, in relation to practices carried on by such persons;

b) the payment of a levy imposed on the approved regulator under 173;

c) the participation by the approved regulator in law reform and legislative process;

d) the provision by relevant authorised persons, and those wishing to become relevant authorised persons, of reserved legal services, immigration advice or immigration services to the public fee of charge;

e) the promotion of the protection by law of human rights and fundamental freedoms;

f) the promotion of relations between the approved regulator and relevant national or international bodies governments or the legal professions of other jurisdictions.

31. A current consultation from the LSB suggests adding to the list of permitted purposes work connected with improving the citizen awareness of legal rights. The Law Society is likely to support that suggestion.

32. A question is thus how the costs of non-regulatory work paid for from practising fees should be allocated between fees charged to individuals and fees charged to entities.

33. It is not easy to disentangle whether particular activities are more relevant to individual solicitors or to the entities through which they practice. Although some work can reasonably be allocated to one side or the other—for example, work to improve practice management might be regarded as primarily relevant to entities, whereas work in relation to human rights might be regarded as more relevant to individual solicitors—most of the work can be regarded as straddling both. For example, work in promoting relations with international bodies, aimed primarily to open up the legal market in other jurisdictions, is clearly relevant to the firms who wish to practise in particular jurisdictions. But it also provides additional opportunities for individual lawyers qualified in England and Wales to practice overseas.

34. In our view, it is unlikely to be productive to seek to achieve a detailed split of the costs of non-regulatory work (section-51-permitted purposes) between that which is more relevant to entities and that which is more relevant to individuals. Accordingly, we suggest that the attribution of costs should either be allocated

- so that half falls to individuals, while half falls to entities, or

- in the same way that the costs attributable to regulation are allocated above.

What is the impact?

35. Reducing the amount collected from individuals and collecting more from firms will have a significant impact. Firms in private practice who currently pay the fees for their solicitors will pay less for individual practising certificates and more through the firm-based fee. However, solicitors in local government, the CPS, and commerce and industry will only be paying the individual fee—not the firm-based fee. Many such solicitors and their employers will welcome that, particularly as many have felt that they are currently paying too much. But the inevitable consequence is that an additional burden falls on firms in private practice.

36. It is difficult to assess at this stage what the impact will be on particular firms, as other factors will also have an impact—such as whether a firm employs more or less than the "average" number of solicitors.

37. Before implementing any new fee structure, it needs to be clear that the benefits of increased fairness overall justify the effects of an increased burden on private practice.

Questions 1 and 2

1. Do you agree with the "principles and objectives of any new fee policy" outlined in paragraphs 19 and 20 above?

2. Do you agree with the following principles?

    - Fees charged to individuals should only cover the cost of those activities associated with the regulation of individuals (regardless of whether they work in private practice or not), rather than firms.

    - Firms should pay a firm fee, to cover the remaining costs (i.e. the cost of activities associated with the regulation of private practice).

Individual fees

38. In order to develop a fair new policy, we have considered how other regulators have developed fee policies—in particular, those who charge firms rather than individuals—and have identified a number of common principles.

39. Our starting point—from the application of the principles set out in paragraphs 19 and 20—is to make it as simple as possible by charging a flat rate fee to all regulated individuals. We have considered whether a flat fee would be fair across individuals working in different environments. Our initial conclusion is that a flat fee would be fair, because—broadly—our regulatory activities apply similarly to individual solicitors in commerce and industry and local government as to solicitors employed in private practice (whether in an SRA-

regulated firm or in a firm regulated by the Council for Licensed Conveyancers).

40. At present, because the annual PC fee is high, a number of reductions are allowed to reflect ability to pay for newly qualified solicitors, solicitors returning from maternity leave, low earners, etc. These reductions do add to the cost of collection. If the fee is much lower, the rationale for further reductions and special cases would appear to be less.

Question 3

3. Do you agree that the individual (i.e. practising) fee should be the same for all solicitors, regardless of the environment in which they work (e.g. commerce and industry, local government, private practice, etc.)?

Recognised body fees

Approach to firm-based fee structure modelling

41. We have considered a number of possible fee-structure options with the aim of increasing fairness by considering other variables in addition to regulated individuals as a way of calculating fees—in particular, also taking account of

- all fee earners (lawyers and non-lawyers),
- firm turnover.

42. We have also considered the extent to which the risk-based approach to regulation should influence fee policy. The FSA has concluded on this that "at the level of individual firms there is no strong link between risk, regulatory activities and resources (and therefore fee)."

43. At present, although we are developing risk-based regulation, we do not have sufficient data to tell us where the different activities of firms have a measurable impact on the amount of regulation required. For now, the only distinction we can make is between the regulation of solicitors as individuals, and the regulation of firms providing legal services to the public (private practice).

The case for using size of business as a proxy for benefits of regulation

44. Having recognised that we cannot apportion the fees on the basis of the regulatory risk presented by firms or on the basis of how much it costs to regulate different firms, the factor most likely to meet most of the principles is some measure of size. A firm's scale of business is a proxy for the potential risk posed by the firm. Clearly, the number of solicitors or even other authorised persons in a firm alone is no longer a good enough measure, as many firms also contain a varying number of non-lawyer fee earners.

The case for using total fee earners as a variable (and definition of fee earner)

45. If the number of fee-earning staff providing legal services is a valid measure (and it is used by other regulators), then, clearly, we need to look at the total number of fee earners rather than just solicitor or other qualified fee earners.

46. In the PC renewal exercise in 2009, we will be asking firms to let us have the total number of fee earners employed, and will use the following definition:

    "Total number of full time equivalent (FTE) individuals (lawyers and non-lawyers) generating fee income for a firm"

    Examples of fee-earner roles

    - Solicitor or other lawyer (e.g. barrister, legal executive)
    - Trainee solicitor
    - Paralegal, research assistant, non-lawyer consultant
    - Specialist support staff
    - Support/administrative staff doing fee earning work

    This would exclude support/administrative roles that might result in incidental expenses/disbursements (e.g. photocopying).

47. This definition has the advantage of being clearly linked to the generation of income for firms. It is also straightforward to understand and calculate, and is less open to interpretation and manipulation. For this purpose, a regulated individual working three days per week should be counted the same as non-lawyers who spend 60 per cent of their time on activities which generate fee income and 40 per cent of their time on non-fee-earning activities (e.g. admin support). Each of these individuals would represent 0.6 FTE.

The case for using turnover as a variable (and definition of turnover)

48. We have looked at what other regulators do. There is a great variety. The most common measures are turnover or number of persons engaged in delivering regulated services (fee earners). Turnover is the basic indicator of both the level of activity and the value of that activity, and, prima facie, of the regulatory risks. It is also an indicator of the benefit of regulation.

49. Our initial conclusion is that turnover, either alone or perhaps in conjunction with the number of fee-earning staff, best meets the principle of fairness. It also meets the other principles—being simple, stable and verifiable.

50. Profitability is not a good measure, as it is much less verifiable. It could also lead to inconsistencies and, so, unfairness.

51. The profession has had experience of turnover being used as the starting point for the calculation of insurance premiums by the Solicitors Indemnity Fund (SIF).

52. It has already been agreed that information on turnover should be collected during the 2009 PC renewal process for firms. The definition we are using is set out below. Note that this definition is as per the minimum terms and conditions for qualifying insurers providing indemnity insurance:

"The firm's total gross fees from the last complete accounting period, arising from work undertaken from offices in England and Wales"

Guidance

- "Gross fees" to include "all professional fees of the firm for the latest complete financial year including remuneration, retained commission and income of any sort whatsoever of the firm (including notarial fees)."

- Specifically excluded: interest, reimbursement of disbursements, VAT, remuneration from a non-private-practice source, dividends, rents and investment profit.

- This should be same as is submitted to a firm's indemnity insurer for this 2009 period (i.e. for the period of cover from 1 October 2008 to 30 September 2009), so that there should be no extra work for the profession to gather this information.

Preferred models – high-level concepts

53. A series of options for a new fee structure has been modelled to consider how best to complement the changes discussed in the sections above based on the principle of the fair treatment of individuals and the different firm structures.

54. The SRA has developed a series of models based on the use of turnover, regulated individuals and fee earners (both solicitor and non-solicitor) as variables. Each of the models was then considered, in terms of pros and cons as against the principles (paragraphs 19 and 20 above) and the expected impact of the model on different types of firm and individuals.

55. The models we think best fit are set out in a little more detail below—although more work is required. On balance, we favour Model 2, which is a simpler measure taking into account a single factor—turnover. We would be interested in your views as to whether the third, more complex, model has sufficient benefit in terms of fairness to override the need for a simple structure.

56. While they introduce an additional level of complexity in terms of calculating the fees payable, there is an argument for models which use banding, rather than treating firms of vastly ranging size and structure exactly the same. Banding reduces the effect whereby outlier firms are either vastly advantaged or vastly disadvantaged, and is consistent with the approach taken by some

other UK regulators. Ofcom's administrative charges are calculated by applying a percentage tariff to the relevant turnover. When relevant turnover falls within a band, Ofcom uses the lower figure of the turnover band to calculate the administrative charge payable.

Model 1

57. Entity fees are based on firms paying a flat sum per FTE fee earner. This fee would be calculated simply by dividing the total cost to be collected evenly across the total number of fee earners in the profession.

    A variant of this model could be to band firms on the number of fee earners they have. Banding allows for some adjustment that could assist fairness (e.g. to producing a tapering effect, reducing the fee per fee earner for larger firms).

Model 2

58. Firms are banded according to annual turnover generated from fees. Proportion of annual turnover to be charged as firm fee is allocated to each band on a tapered scale. That is, the higher a firm's turnover, the lower the percentage of that turnover they will pay in fees. This is similar to the approach formerly taken by the SIF.

Model 3

59. Firms are banded according to annual turnover generated from fees, then a sliding scale of fees per fee earner applied to bands (decreasing as firm turnover increases). Firms would be charged on the basis of a specified sum per fee earner, but the sums themselves would be lower for firms in the higher turnover bands than in the lower bands.

Effects on individual firms

60. Each of the models will have differing impacts on firms depending on their size and structure. It is difficult to foresee the exact impacts in terms of fee increases (or decreases) on individual firms, or on groups of firms, until we have a complete and accurate picture of the data which is being collected as part of the 2009 PC fee collection exercise (namely, turnover and fee-earner data). However, we can draw some general conclusions from the principles behind each of the above proposed models in terms of the firms likely to be most affected by the changes.

61. In addition, it is important to note that any model based on a principle of banding firms will allow us to adjust the figures and calculations for each band to give greater fairness and to ensure that no one group—for example, low income groups or larger city firms—is shouldering more than their fair share of the increase in fee burden. But this is, of course, a zero sum game: Measures to alleviate the burden on one sector inevitably lead to an increased burden on some other sector or sectors.

62. Broadly speaking, the firms most likely to be adversely impacted by the new fees structure are those that have an above-average proportion of non-solicitor fee earners who, in the past, have been able to earn income for the

firm without contributing towards the cost of regulating the activities that generate such income.

63. Those firms with a higher-than-average proportion of solicitor fee earners could experience only a small increase, or even a decrease, in fees—if the decrease in the cost of PC fees outweighs the additional firm fee they must contribute. But the overall burden on private practice will plainly increase, because the fees charged to solicitors in local government, and in commerce and industry, will decrease.

64. If a model which uses turnover as the only variable is implemented, how significantly a firm is impacted will depend on whether they currently pay a higher-than-average or a lower-than-average amount for PC fees as a proportion of their turnover. Those that have a higher-than-average number of solicitors holding PCs and a lower-than-average turnover could experience only a small increase, or a decrease, in fees.

65. If a model which uses a combination of fee earners and turnover to calculate the firm fee is implemented (where a lower fee per fee earner is charged for firms with a higher turnover), the firms which may benefit will be those with a relatively low number of fee earners to a relatively high turnover. Firms which are more transactional (i.e. a higher number of fee earners and lower annual turnover) could experience a more significant increase in fees.

66. Again, the above paragraphs highlight only a few scenarios and are very high-level generalisations. Getting a more accurate picture of impacts will only occur once we have a view of the 2009 PC fee renewal data. It will also depend on the make-up of each individual firm in terms of whether they have

- a higher-than-average or lower-than-average proportion of non-solicitor fee earners,
- a higher-than-average or lower-than-average number of fee earners overall,
- higher-than-average or lower-than-average turnover,
- higher-than-average or lower-than-average turnover in relation to number of fee earners overall.

Questions 4–12

4. Do you agree with the principle of using size (either annual turnover generated by legal fees or number of fee earners) as a proxy for the benefits of regulation?

5. Do you agree in principle that, if the PC fee was set low enough (e.g. at or below the current low income PC fee), special cases and reductions should be ruled out?

6. Do you agree with our definition of turnover (paragraph 52)?

7. Do you agree with our definition of "fee earner" (paragraph 46)?

8. Do you think that using two variables (i.e. fee earners **and** turnover) to calculate fees gives great fairness than a model which uses just one variable?

9. How easy would it be to identify accurately how many FTE fee earners are working in your firm?

   - Easy—we already collect and collate this information.
   - Straightforward—we have all relevant information on numbers of fee earners but do not collate this currently.
   - Difficult—we do not hold detailed information on numbers of full-time and part-time fee earners.

10. Which of the models in your opinion is the fairest for the profession and why?

    - Model 1
    - Model 2
    - Model 3

11. How do you think your firm or the group that you represent will be impacted by the model you selected?

12. Which of the models would you describe as "the worst case scenario"?

Special cases

New firms

67. New firms now have to make an application to become a recognised body, and that fee is currently set to cover the cost of the application process. We would propose to set a fixed fee, varying with the time of year when a firm sets up, to cover the cost of regulating new firms which have no relevant record of turnover for the first year of operation. This may be set at the minimum fee payable by firms with turnover.

Firms closing or splitting

68. Many new firms, however, are formed as a result of an existing firm splitting. It would be possible, therefore, to base the fees for the first year for such a firm on turnover. However, as it would be difficult to calculate and apply, we do not propose to reduce the current year's fee to the original firm in such circumstances. Therefore, our provisional view is that the same fixed fee as is charged to new firms should also be charged to firms created as a result of a split, during the first year of operation.

Overseas offices

69. Overseas offices create an additional difficulty, as they are regulated in a different way (e.g. some are required to submit accountants' reports, while some are not). We do not think it is fair to charge overseas firms in the same way as domestic offices. It may be necessary to think about charging a flat rate fee to those that add to regulatory cost. We would welcome your view on this.

Sole practitioners

70. Sole practitioners are not regulated as recognised bodies in the legislation, but amendments to the Solicitors' Act ensure that they can be regulated as firms, and a differential PC fee can be applied to sole practitioners. We propose that the differential PC fee should be calculated on the same basis as the fee for recognised bodies.

Questions 13–17

13. Do you agree with a fixed firm fee for new firms (paragraph 67)?

14. In reference to firms which split or close, resulting in the creation of new firms, do you agree that

    - there should be no reduction in current year's fees already paid by the closing firm, and
    - the same flat fee charged in paragraph 68 should be charged to any resulting new firms?

15. Do you agree that overseas offices should be charged a flat firm fee on top of any PC fee payments to cover the additional administrative/regulatory cost of those firms which need to submit accounting reports to the SRA each year?

16. Do you agree that sole practitioners should contribute a firm fee as per the same fee structure as a firm with multiple partners and/or fee earners?

17. What are your views on whether overseas offices should be charged an additional flat fee to cover the specific regulatory cost that they generate?

Impacts of the new regime on private practice

Shifting the fee burden

71. We believe the proposed change to the fees structure will be fairer. However, as already noted, it will result in an increase in the fee burden to private practice. We understand that, in the current economic climate, this shift will not be popular.

72. Given that one of our principles is that fees should not change considerably year on year, we would welcome views on whether to make the change over a period of years rather than in one year. For example, in 2010 we could start by collecting 50–60 per cent of the AFR through individual fees and the remainder from firms—moving, over a period of time, to 30 per cent from individuals and 70 per cent from firms.

Question 18

18. In relation to the shifting of the fee burden onto private practice that will result from reducing the PC fee, do you favour adopting a phased approach to bring full impact over a period of years?

Transparency and process

Consulting the profession

73. Feedback on the new fees regime will be gathered during two, separate, three-month consultation periods. The first consultation period runs from late June 2009 until the end of September 2009.

74. When the first consultation period ends, the Law Society and the SRA will consolidate and analyse feedback. The second consultation period will begin in late 2009. It will be a more in-depth, detailed consultation to gauge responses from the profession in relation to

- preferred models,
- how fees will be calculated,
- guidance as to how firms could estimate their 2010 fee (based on 2009 fees and budget),
- more-detailed estimated impact analysis,
- application process,
- appeals process.

75. The second consultation period will end in late February 2010. Final outcomes and policy will be published in April 2010.

Impact of the EU Framework Services Directive

76. As part of the response to the Framework Services Directive, the SRA and the Law Society are committed to ensuring the necessary transparency in terms of clearly defining the cost of application and renewal fees and the cost of regulation. These fee structures—and new technology we are introducing—will enable much greater transparency.

Compensation fund contributions

The impact of the LSA 2007 also calls into question the current way in which the cost of the compensation fund is allocated.

Current contribution fund regime

77. Currently, the compensation fund contribution is collected as an individual contribution as part of the PC renewal exercise.

78. The key distinguishing factor is whether or not the solicitor holds client money—that is, is a "manager" (partner, director, member) of a firm in private practice. A small number of in-house solicitors or other fee earners within firms may also hold client money and, so, pay the higher amount. Other solicitors pay a lower amount, although there are some complicated exceptions for newly qualified solicitors etc. Currently, around 40 per cent of solicitors hold money and pay the higher amount.

Principles and objectives of a new compensation fund regime

79. While many of the principles are common to both regulatory fees and contributions, it is often argued that risk (i.e. the risk of actually causing a claim on the compensation fund) should be a relevant factor. The compensation fund is a key client protection, and is required to give the public confidence in the profession as a whole. Accordingly, the current policy is that the whole profession, and particularly those whose businesses hold client money, benefit from the existence of the fund, and should contribute to it. Other regulators with compensation funds also spread the cost among the regulated community on this basis, rather than basing contributions at risk.

80. We know, however, that there are some different views within the profession. Many see it as unfair that larger firms have to contribute so much, as they would only give rise to claims on the fund at present in the event of the dishonesty of all the partners. That is because most losses in such firms, even through dishonesty, are covered by insurance (paid by the firm). However, since claims arise only in respect of dishonesty, it would arguably be at least as "unfair" to load contributions onto the vast majority of sole practitioners, who are honest, as it is to require large firms to contribute in proportion to their size.

81. If a so-called risk-based model to contributions to the fund was adopted, the cost would be borne almost entirely by sole practitioners and small firms. That would have a serious impact on the viability of small firms and on access to justice. It would take no account of "ability to pay" as a principle.

82. These are difficult issues. Reducing the likelihood and, so, the cost of claims on the fund is an important objective for the SRA, but it cannot be tackled overnight. However, the need to review the basis for allocating the cost of the fund should be addressed now, so that we can implement the changes in a cost-effective way at the same time as making the changes in relation to the practising fee.

83. The contributions to the compensation fund at present cover the cost not only of claims and the handling of claims, but also of a number of regulatory activities undertaken by the SRA (such as the cost of the forensic investigation team), which are carried out partly in order to protect the fund from claims arising. If that work were not charged as part of the compensation fund contributions, the cost would come down considerably, although that work would then need to be funded through other regulatory fees.

Allocation of contributions between individuals and firms

84. The distinction between those who hold client money and those who do not hold client money could be seen as a proxy for allocating a percentage of the cost of the fund to be borne by firms rather than individuals. When only solicitors could be "managers" of a firm, that notion made some sense. However, the advent of LDPs calls it into question. The SRA has no power to collect a compensation fund contribution from individual non-solicitor managers of an LDP. Some solicitors may therefore feel that LDPs are not contributing fairly to the compensation fund. There is an argument as to whether individual solicitors should make any contribution at all. The risk to the fund occurs when a firm acts for clients and holds client money. On the other hand, the existence of the fund gives confidence to the public in the profession as a whole, and a small contribution may be seen as part of the responsibility of all those in the regulated community. Our current proposition would be to continue to charge a low fixed fee to all individual solicitors, including those in the employed sector.

Allocation of firm contributions

85. We believe that there are good reasons to apply the principles discussed in the rest of this paper to compensation fund contributions:

- Collect a fixed sum from all individual solicitors—wherever and however they practice.
- Collect an additional amount from any solicitors not in private practice who hold client money.
- Collect the balance from firms in private practice.

Questions 19–23

19. Do you agree with the following principles for collecting the total compensation fund contribution from the profession?

    - Collect a percentage of the compensation fund contribution from all individuals—wherever and however they practice at a fixed rate.
    - Collect an additional compensation fund contribution amount from any solicitors not in private practice who hold client money.
    - Collect the balance of the required compensation fund contribution from firms in private practice.

20. In terms of the split between total individual compensation fund contributions and total firm contributions, do you agree with the principle of recovering the same proportionate split as for the practising fees versus entity fees?

21. Should firm contributions to the compensation fund only be paid by those firms in private practice who hold client money?

    - Yes, they are the firms at greatest risk of causing the compensation fund to pay out.
    - No, all firms should contribute—the compensation fund is a key client protection, and is required to give the public confidence in the profession as a whole.

22. What should be the factor determining the amount that a private practice firm (holding client money) contributes to the compensation fund (in addition to any contributions it makes on behalf of its individuals)?

    - Size (amount of client money held)
    - Risk of causing a claim on the compensation fund

23. Do you agree that there should be an additional compensation fund contribution amount from any solicitors not in private practice who hold client money?

Complete list of questions

1. Do you agree with the “principles and objectives of any new fee policy” outlined in paragraphs 19 and 20 above?

2. Do you agree with the following principles?

    - Fees charged to individuals should only cover the cost of those activities associated with the regulation of individuals (regardless of whether they work in private practice or not), rather than firms.

    - Firms should pay a firm fee, to cover the remaining costs (i.e. the cost of activities associated with the regulation of private practice).

3. Do you agree that the individual (i.e. practising) fee should be the same for all solicitors, regardless of the environment in which they work (e.g. commerce and industry, local government, private practice, etc.)?

4. Do you agree with the principle of using size (either annual turnover generated by legal fees or number of fee earners) as a proxy for the benefits of regulation?

5. Do you agree in principle that, if the PC fee was set low enough (e.g. at or below the current low income PC fee), special cases and reductions should be ruled out?

6. Do you agree with our definition of turnover (paragraph 52)?

7. Do you agree with our definition of “fee earner” (paragraph 46)?

8. Do you think that using two variables (i.e. fee earners and turnover) to calculate fees gives great fairness than a model which uses just one variable?

9. How easy would it be to identify accurately how many FTE fee earners are working in your firm?

    - Easy—we already collect and collate this information.

    - Straightforward—we have all relevant information on numbers of fee earners but do not collate this currently.

    - Difficult—we do not hold detailed information on numbers of full-time and part-time fee earners.

10. Which of the models in your opinion is the fairest for the profession and why?

    - Model 1

    - Model 2

    - Model 3

11. How do you think your firm or the group that you represent will be impacted by the model you selected?

12. Which of the models would you describe as “the worst case scenario”?

13. Do you agree with a fixed firm fee for new firms (paragraph 67)?

14. In reference to firms that split or close (resulting in the creation of new firms), do you agree with the following statements?

    - There should be no reduction in current year’s fees already paid by the closing firm.

    - The same flat fee charged in paragraph 68 should be charged to any resulting new firms.

15. Do you agree that overseas offices should be charged a flat firm fee on top of any PC fee payments to cover the additional administrative/regulatory cost of those firms which need to submit accounting reports to the SRA each year?

16. Do you agree that sole practitioners should contribute a firm fee as per the same fee structure as a firm with multiple partners and/or fee earners?

17. What are your views on whether overseas offices should be charged an additional flat fee to cover the specific regulatory cost that they generate?

18. In relation to the shifting of the fee burden onto private practice that will result from reducing the PC fee, do you favour adopting a phased approach to bring full impact over a period of years?

19. Do you agree with the following principles for collecting the total compensation fund contribution from the profession?

    - Collect a percentage of the compensation fund contribution from all individuals—wherever and however they practice at a fixed rate.

    - Collect an additional compensation fund contribution amount from any solicitors not in private practice who hold client money.

    - Collect the balance of the required compensation fund contribution from firms in private practice.

20. In terms of the split between total individual compensation fund contributions and total firm contributions, do you agree with the principle of recovering the same proportionate split as for the practising fees versus entity fees?

21. Should firm contributions to the compensation fund only be paid by those firms in private practice who hold client money?

    - Yes, they are the firms at greatest risk of causing the compensation fund to pay out.

    - No, all firms should contribute—the compensation fund is a key client protection, and is required to give the public confidence in the profession as a whole.

22. What should be the factor determining the amount that a private practice firm (holding client money) contributes to the compensation fund (in addition to any contributions it makes on behalf of its individuals)?

    - Size (amount of client money held)

    - Risk of causing a claim on the compensation fund

23. Do you agree that there should be an additional compensation fund contribution amount from any solicitors not in private practice who hold client money?

24. Do you think any of the principles or proposals in this paper are likely to have a negative or positive effect on any particular groups? If so, please give details.

How to respond

For information on how to respond, please visit our website.

- Go to www.sra.org.uk/consultations.
- Select **Moving toward a fairer fee policy**.
- Click **How to respond**.

Submission deadline

The deadline for responses is 28 September 2009.