

# Moving toward a fairer fee policy

Second consultation

Report on responses to consultation paper 21

## **Contents**

<b>Introduction .....</b>	<b>3</b>
<b>Responses to the questions .....</b>	<b>6</b>
Fee structure charging proposals .....	6
Impact on the profession.....	11
Renewal Process .....	12
Special cases.....	15
Any other general comments .....	18
<b>Conclusions.....</b>	<b>19</b>
<b>Appendix 1 (Response from the Law Society) .....</b>	<b>20</b>

## Introduction

1. The second consultation on *Moving towards a Fairer Fee Policy* (number 21) was part of a wider engagement strategy designed to seek the views of the profession, its representative bodies and other stakeholders on how the costs of regulation should be shared and what the best approach to establish a fairer fee charging structure should be. It followed from the earlier consultation (number 19), in which the SRA and the Law Society consulted on the broad principles that should apply to a new fee structure for 2010.<sup>1</sup>
2. The second consultation paper focused on explaining the rationale and showing the calculations behind the proposed regulatory fees and Compensation Fund contributions. It also provided examples of what the potential impact of the proposals might be on firms of different sizes, elaborated the various options for the renewal process, and outlined considerations relating to “special cases” such as new firms, mergers and splits.
3. The consultation was launched on 07 December 2009 and closed on 22 January 2010. It was open for comments for seven weeks. It posed 16 questions on the various proposals and covered the more detailed rules and processes for the changes to the funding structure.
4. This report presents analysis of the feedback received and provides the key points made by respondents. We received 45 responses to the questionnaire together with 10 general responses by email and post. All of the responses have been taken into account and fully considered.
5. We would like to thank everyone who took the time to respond to this consultation, and the effort was evident in the quality of responses.

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<sup>1</sup> Details on the earlier consultation, as well as a report on responses to that consultation, are available on our website at: [www.sra.org.uk/sra/consultations/consultations-closed.page](http://www.sra.org.uk/sra/consultations/consultations-closed.page)

Comments and responses received have been extremely helpful and provided some very useful feedback on the proposed fee structure.

6. The responses were submitted by, or on behalf of, a range of local law societies and representative bodies as well as individual solicitors from different sectors and law firms of varying sizes. In our analysis we have not given a particular weighting to the responses. It is difficult to weight a response from a representative body against a response from an individual, or an individual firm, but a reference, for example, to a view receiving “broad support” is not the result of a pure quantitative analysis counting each single response as having equal weight with all others.

The list of respondents to the consultation is as follows:

- Association of Council Secretaries & Solicitors (ACSeS)
- Advice Services Alliance (ASA)
- Birmingham Law Society (BLS)
- Birmingham City Council (BCC)
- Bar Standards Board (BSB)
- Hampshire Incorporated Law Society (HILS)
- Institute of Legal Executives (ILEX)
- Lawyers with Disability Division (LDD)
- National Trust for Places of Historic Interest or Natural Beauty (The National Trust)
- Network Rail Infrastructure Limited (Network Rail)
- Refugee and Migrant Justice (RMJ)
- Risk & Compliance Group (RCG)
- Solicitors in Local Government Ltd (SLG)
- Solicitors Sole Practitioners Group (SSPG)
- The City of London Law Society (CLLS)
- The Law Society of England and Wales (TLS)
- The Law Society's Conveyancing and Land Law Committee (CLLC)
- 1x representative body (who wished to remain anonymous)
- 1x local authority (who wished to remain anonymous)
- 17x private practice firms (including sole practitioners)
- 17x individuals
- 2x other

7. In brief, we found broad agreement on:

- the banded turnover model as the best available option for calculating the firm fee but with certain limitations, and that it should be a 'stepping stone' towards a more risk-based approach in the future
- the Compensation Fund to be used and funded by both individuals and firms, and the contributions to pay only the direct costs of claims, handling of those claims and any necessary reserves
- a one-stage renewal process (based on the turnover figures submitted during the previous year's renewal cycle) to be the preferred option of respondents as the simplest, providing certainty to the profession and keeping the administrative costs to the minimum

The main concerns raised by respondents were:

- a lack of clarity as to whether a particular firm or business would have to pay the firm based fee:
  - a) some sole practitioners were unsure whether they would have to pay both the 'individual' and 'firm' component. The answer is that, under the proposals, they will pay the individual fee and a fee based on the turnover of the sole practice.
  - b) The other group that were unsure were some local authorities and in- house solicitors. The proposal is that the firm fee will only be payable by Recognised Bodies and Recognised Sole Practitioners, and not by in- house solicitors who will only pay their individual Practising Certificate fee and any individual compensation fund contribution.

We apologise for any lack of clarity in this matter.

- whether the low income discount should be removed and the effect this might have on semi-retired and more senior members of the profession, as well as those working in disadvantaged sectors and less profitable areas of practice such as legal aid.

8. This consultation paper was an important step in the process of gathering views on how to develop a fairer fee structure. Although there was broad consensus on the principles that govern the new fee policy as well as agreement that the one-stage renewal process is the preferred option, there was concern that historic turnover data may affect ability to pay, if a firm's

turnover is unstable. Although a firm should be able to undertake financial planning for any fluctuations in their fixed costs, the overhaul of the existing fee structure creates a need for the SRA to provide a process for appeals to facilitate a smooth transition to the new funding arrangement. In the third consultation on an Appeals Process, we will discuss the options that are available, the eligibility criterion that would need to be satisfied and the impact this provision would have on the profession. This consultation is likely to be launched by the end of February 2010 and will be open for 6 weeks.

## Responses to the questions

### Fee structure charging proposals

#### Discussion points

1. Do you broadly agree with our conclusion that banded turnover is the best model for the firm based fee? If not, please give your reasons.
2. Do you agree that the split between the individual and firm allocation should be 40/60? If not, please give your reasons
3. Do you have any further comments on the proposals in the section dealing with the regulatory fee (Section 3: Fee structure charging proposals)?
4. Do you agree with the SRA proposal that the Compensation Fund should only be used and funded to pay
  - the direct costs of claims,
  - the costs of handling those claims, *and*
  - any necessary reserves?
5. Which option for funding the Compensation Fund do you prefer, and why? If you think there is another option, please give details.
  - Option 1: Individual: Flat | Entity: Flat Fee
  - Option 2: Individual: Flat | Entity: Turnover-based (options 2a and 2b)
  - Option 3: Individual: Flat | Entity: based on number of partners/members/directors

9. An overwhelming majority of respondents by number agreed that the banded turnover model was the best available option for calculating the firm fee - accepting that there were certain limitations to the chosen option, and that it should be a temporary arrangement *until* a risk-based approach to the funding structure was further developed. The CLLS, along with some other respondents, preferred the fee earner model.

10. Many respondents emphasised the need for clarity:

*“as to the definition of 'turnover' and the 'bands' to avoid complications/confusion arising from various accounting practices within law firms and/or their subsidiary branches.”* [BCC]

Those who were unclear as to whether the firm fee would apply to local authorities and other public sector organisations had particular concerns, although in fact such bodies will not be subject to the firm fee.

11. There were, however, some reservations as to why the turnover model had to be banded or why tapering would make it fairer for firms of different sizes. The Hampshire Incorporated Law Society (HILS) expressed their disagreement with banding as potentially leading to discrimination against smaller firms.

12. Others opposing the proposed banded turnover model also expressed their concerns that it would discriminate against smaller firms, or that it would bring *“a disproportionate impact on the most efficient firms which are also typically those who have invested in effective risk management processes and systems, have higher ratios of qualified to unqualified fee earners, and so require least supervision”*. [CLLS]

13. The Risk & Compliance Group (RCG) suggested that it *“will result in a substantial increase in fees for some larger firms”*. The RCG further argued that *“the firm's scale of business is not necessarily a proxy for the potential risk posed by the firm”* as such a firm is often better prepared to manage and mitigate risks and is more likely to *“invest heavily in robust systems, controls and specialist risk management/compliance expertise”*. They disagreed that *“the banded turnover proposal is either fair or a measure of consumption of regulatory resource”*. The fee structure, therefore, should take account of risk and, they believed, it was feasible to determine the impact of the different activities of the firms on the amount of regulation required with the current data held by the SRA if it was *“properly mined”* and assessed. Similarly the Institute of Legal Executives (ILEX) concluded that: *“[t]here appears to be little evidence of a reciprocal relationship between turnover and regulatory risk”* and for the proposed model to be based wholly on turnover without considering other factors *“seems to be largely based on perceived risk rather*

*than on actual risk". The RCG suggested offering "large firms with robust case management systems and good control over staff [...] some form of "premium reduction" for investing heavily in systems and controls".*

14. The majority of those who agreed with the proposed 40/60 per cent split between the individual and firm allocation strongly emphasised that it was a 'starting point' which should be reviewed in the future so as more accurately to reflect the regulatory burden (and thus move closer to 20/80 per cent).
15. Some respondents opposed the need to phase the approach, as the proposed structure would still remain unfair to solicitors employed in commerce and in the public and charitable sectors. An employed solicitor argued that the individual component should be closer to 25 per cent or less as otherwise:

*"firms will apply even more pressure than they may do now to individuals and refuse to pay the fee except where the job performed requires a current PC. That could both damage the careers of the individuals and lead to income shortfall".*

Similarly, the National Trust said that *"unless the split moves to the 30/70 basis in short measure we believe the SRA should look again at lower individual fees for in-house lawyers".*

16. The Advice Services Alliance (ASA) was content overall with the proposals, but some others raised further concerns with regard to not-for-profit (NFP) organisations as it was felt that *"the proposed changes for next years PC costs do not [go] far enough in reducing the cost burden and further discounts need to apply".* Owing to the nature of the work that these organisations provide *"any income that is generated is fed back into the organisation".* The point was made that the number of complaints raised against NFPs is very low and so is the cost of investigating these complaints. It was also suggested that *"other fees or subscription system" take into account the impact such costs have on charitable organisations and NFPs, "whereas the costs associated with renewing practising certificates do not"* and so it was felt that *"NfPs have to bear an unfair and unreasonable burden by employing solicitors" [RMJ].*



17. It was also suggested that the cost of Practising Certificates had for too long been unfair to local authorities, and that a split of 20/80 per cent ought to be introduced in the first year [ACSeS; BCC]. This was justified on the grounds that the regulatory burden of local government solicitors was less than that of the private sector, and *“any assessment of affordability must properly evaluate the impact upon the difficult financial position of local authorities”*. It was proposed that such solicitors should pay *“the exemption rates paid by the Government Legal Services and the CPS to Local Government solicitors with immediate effect”* [Ibid.]
18. The Law Society (TLS) took an opposing view and suggested that the split should be 50/50 per cent at the beginning as *“a lot of the activities which the SRA regulates are the responsibility of both the individual’s behaviour and entity’s systems. At the outset it is sensible to allocate costs which could fall either side to the individual PC fee”*, and this would ultimately *“smooth the process of change for all those who are regulated and allow the SRA more accurately to judge where burdens should fall”*.
19. Some respondents raised concerns about the overall cost and level of fees charged by the SRA in comparison to some other similar regulatory bodies, especially given the current economic climate, and criticised the proposals for not taking into consideration other pressures on the profession (i.e. rising costs of indemnity insurance, the SRA’s compliance requirements, employment legislation and so forth). It was also suggested by one anonymous respondent that the low income discount should remain on the basis that it was not *“equitable that employees who work part-time and have a low level of income should have to pay the same flat PC fee as those who work full-time”* since working a reduced number of hours also brings a reduction in the amount of the SRA regulatory work *“needed in respect to them [...] when compared to a full-time employee”*.
20. Overall, a significant number of respondents welcomed the changes as aimed at achieving greater fairness and as a first step towards the introduction of a more risk-based approach to regulating the profession. Nevertheless, many respondents pointed out that in order to achieve the ultimate goal it was essential to develop relevant processes and collect the necessary data which would allow the SRA to measure more accurately the regulatory burden and impact of firms’ different activities. The CLLS asked the SRA to provide the

profession with further assurances that commercially sensitive data, such as turnover, was *“not shared widely within the SRA and only access on a need-to-know basis”*.

21. An overwhelming majority of responses supported the proposals that the Compensation Fund (CF) should only be used and funded to pay the direct costs, costs of handling claims and any necessary reserves, which would result in moving indirect costs to the regulatory fund. This was perceived as a more logical and fairer system.
22. However, some voices were raised against the need for solicitors who do not hold client money to pay the CF contribution as *“[w]e see such amounts as a firm-based regulation issue and should be funded accordingly”* [BCC; ACSeS]. Some others raised the issue of whether moving indirect costs out of the CF, but which are related to claims, might amount to increasing the burden on those who do not hold client money and therefore were less likely to give rise to claims.
23. An overall majority of respondents favoured Option 2 (fixed individual and turnover-based entity fee) for the CF fee model as relating ‘more closely to the amount of business’, ‘making the whole system more consistent’, producing ‘the fairest results’, and being ‘the most equitable’. That said, a significant number of respondents conditioned their response on the actual level of these fees i.e. if these were set low enough then Option 1 (flat fee for both the individual and entity) should be chosen as the simplest, but if the fees were to be substantial then Option 2 would be preferred. The Sole Practitioners Group [SSPG] stated that Option 2 *“would be the fairest Option to adopt for the whole of the Profession”*, although, *“Option 3 would be more favourable and probably more affordable to the Sole Practitioner”*.
24. However, a significant number of respondents stated that in their opinion fairness was more evident in Option 1 as *“most accurately [reflecting] the risk profile”* [Private Practice Firm]. Moreover if *“smaller firms are evidentially more likely to be subject to interventions [...] under the model would not be subsidised by larger firms”* [Private Practice Firm]; however:  
  
*“[i]f there is no evidence to support that it is a particular profile of firm in terms of size and work type that claims on the fund, then the burden should be*

*shared fairly and to that end proper consideration should be given to option 2 (a)*" [Ibid.].

25. As one private practice firm further suggested, further data (*"the number of claims made on the compensation fund, the profile of the firms making such claims (i.e. partner size) and the cost of the claims and where they fall"*) would enable them to make more informed comments on the variety of methods suggested for calculating fees for the CF.

## Impact on the profession

### Discussion points

6. The impact analysis is based on comparing the proposed model with this year's funding structure and funding requirement, and is based on sample data. Therefore, the information we have provided is only indicative of the way in which the model will work. We have not presented the actual figures—as the funding requirement for next year is still to be determined. Please bear this mind as you answer the following questions.

6.1. Do you have any comments with regard to the suggested turnover bandings and rates?

6.2. What do you think about the approach to keeping the proportion paid by firms of different pattern bandings as close as possible to the current model?

7. If the 40/60 split between the individual and firm-based fee is adopted, there will be a fee burden shift of 15 per cent from solicitors in the employed sector onto private practice. However, what will have more impact on individual firms is the change to basing firm fees on turnover. For example those with a significantly higher-than-average turnover per practising certificate holder will pay significantly more than before; more than 60 per cent of firms will experience either a decrease or an increase of less than 15 per cent.

7.1. Do our worked examples reinforce and reflect the above?

7.2. Does the information we have provided (i.e. worked examples) help you in assessing how your firm might be affected? Is there any other information you would find helpful?

26. Respondents mainly agreed with the suggested bandings, with one respondent saying that *"I welcome the suggested turnover bandings and rates since they ensure a fairer contribution based on a firm's ability to pay"* [Private Practice Firm]. At the same time another respondent observed that

*“whatever banding rates are employed will produce anomalies where turnover is either just below or just above the level of the bands”* [Private Practice Firm].

27. Some further suggestions included the introduction of intermediate banding(s) between £20,000 and 150,000 (e.g. of £100,000 with an increment of 0.65%, and potentially also at £50,000 level) in order not to penalise small firms with a modest turnover; also an *“[a]dditional tapering relief at say £40 million and seventy million would seem more equitable”* [Private Practice Firm]; and *“introducing further bands above £100m is necessary to avoid overly penalising the larger firms”* or *“[a]s an alternative, we would suggest that a cap on turnover is considered, of say £100m”* [Private Practice Firm].

28. Even though the majority of respondents were content with the worked examples provided, with one stating that *“[t]his is of help to us in understanding future expense”* [Private Practice Firm], it was also indicated by many that at this stage they could not provide any further comments on the provided bandings due to the lack of more detailed information. Access to an online calculator would help significantly with the final decisions and allow for further detailed planning.

## Renewal Process

### Discussion points

8. Please comment on the renewal process you prefer—one-stage or two-stage—and why.

8.1. What might be the impact (both positive and negative) on your firm if it is one-stage process?

8.2. What might be the impact (both positive and negative) on your firm if it is two-stage process?

8.3. Can you think of how else a one-stage process or a two-stage process might affect the profession?

9. Do you think that we should charge additional fees to encourage firms to provide the required information on time? What model do you think is more appropriate for the calculation of such additional fees?

29. Overall the respondents preferred a one-stage process over a two-stage process, although not without some reservations.

30. Some respondents accepted that a two-stage process would be potentially fairer, but nevertheless selected a one-stage process, in the words of one, *“simply because it gives certainty for the profession and keeps costs to a minimum”* [Private Practice Firm]; *“it gives simplicity, continuity and clarity”* [Private Practice Firm].

31. Those in favour of a one-stage over a two-stage process pointed out that the latter would increase *“costs and administration not only with the SRA but internally as well. Simplicity of process is a key element of our internal risk and regulatory procedures”* [Private Practice Firm]; *“would involve replicating the accounting task at additional/duplicated cost”* [Private Practice Firm]; and *“may be particularly burdensome for smaller firms who do not employ accountants in house, or those with less sophisticated accounting and reporting systems”* [CLLS]. The National Trust expressed the view that:

*“we do not consider that the possible anomalies which might arise from using turnover information which is 12 months old are sufficient to justify the additional complexity and administrative cost (both for the SRA and firms) of the two-stage process - administrative costs which ultimately are paid for by the profession as a whole, or by its clients”.*

Moreover, as pointed out by RCG, *“[t]he information that is gathered for the indemnity renewal can be provided to the SRA at the same time of year, thereby keeping costs down”.*

32. Some respondents, however, raised concerns over the significant fluctuations in turnover from year to year for some firms, which would make the one-stage process less fair to them in comparison to those with relatively level turnover. The two-stage process would allow for the figure provided to *“be more in line with our ability to pay at the time of payment”* [Private Practice Firm]. However, as pointed out by RCG:

*“Firms must in order to manage their businesses properly under rule 5 be able to manage and plan their budgets properly. The lack of certainty of figures until September will have a severe impact on firms' financial planning and could in turn have a significant impact on firms' ability to maintain a strong financial base especially in the current economic climate”.* For that

*reason, as they further stated, “[t]he additional costs and changes in process required would not in our view be a justifiable cost to the profession”.*

As noted by CLLS, *“[w]hatever the timing of the turnover snapshot used there will be winners and losers”.*

33. Respondents also felt that some form of incentive *“to co-operate promptly might be advisable”* [Employed Solicitor], with Option 3 (10 per cent levy on the fees due) to be most often chosen by the respondents, followed closely by Option 1 (fixed fee per partner/director).
34. However, many also expressed that if a one-stage process was introduced, then there would be no need for any additional/ penalty fees. The general view was that even if the penalties were introduced, some form of mitigation would be needed in circumstances where, for example, a *“firm in question is the subject of a tax investigation and does not have such financial information immediately to hand”* [Private Practice Firm]; it was also acknowledged that this is a *“considerable step change for the SRA as well as the profession in getting used to the new process”* [RCG].

## Special cases

### Discussion points

10. Do you agree with the rationale of charging UK firms with branches outside of England and Wales a small flat fee in relation to each branch to cover the cost of regulation, or do you think this cost should be borne by the whole profession through regulatory fees? Please comment on any exceptions and/or anomalies that the described options might bring.

11. Please give us your views on whether you support our proposal to charge new firms / sole practitioners in their first practising year:

- A flat not-pro-rated application fee of £180 for new firms, and £90 for sole practitioners
- No further contribution to the Compensation Fund

12. Please give us your views on whether you support our approach to new firms / sole practitioners at first renewal:

- New firms with turnover data for less than three months will provide an estimated turnover value similar to that which is provided to indemnity insurers (but only with England and Wales turnover).
- If turnover data is available for a part year (i.e. more than three months), this should be scaled up pro rata.

13. Please give us your views on how the SRA should approach setting fees for firms that have merged, and comment further on the following options proposed by us on what these fees should be based on.

- Option 1: the combined annual turnover for the last accounting period for the different firms prior to the merger
- Option 2: the actual turnover generated since the merger which will be scaled up to reflect the yearly gross fees of the merged firm

14. Please give us your views on how the SRA should approach collecting fees from firms that have split part way through the practising year, and comment further on the following options we have proposed.

- Option 1: Charge the splitting entities their corresponding stakes based on the combined turnover for their last accounting period. The onus is on the profession to establish the split percentage.
- Option 2: Charge the splitting entities on their actual turnover generated since the split, which will be scaled up to reflect the yearly gross fees of the new independent firm.
- Option 3: charge only the firm that retains the majority of the business post split for the entire turnover.

15. In line with the principles of fairness, do you agree that the SRA should adopt the same approach of charging a small flat fee for each overseas office for foreign firms with branches in England and Wales? Are there any other options that you might regard as reasonable?

35. Many respondents felt that if the SRA put resources into regulating overseas branches of UK firms, then they should be charged accordingly, and the fee should reflect *“the cost of regulation of such branches”* [Network Rail], and be *“equal and proportionate to the number of practising certificate holders in those overseas offices”* [Private Practice Firm]. However, as one respondent noted, it would be necessary to clearly define a ‘branch’, as there might be situations where, for instance, a firm has *“consultants on their books that work overseas but not an office”* [Private Practice Firm].

36. Views were divided as to the level of charges for new firms / sole practitioners in their first practising year. Some welcomed the proposals as the *“set up costs for new firms or sole practitioners are already high and in some cases they are prohibitive”* [Employed Solicitor]. Some others, however, felt that the start-up fee should not be a barrier to entry for a new business, but at the same time should be realistic and therefore be:

a) based on the projected turnover as *“[a]fter all any business which starts trading for the first time must have a business plan which would include estimated turnover for the first three years”* [Private Practice Firm], and especially that *“a new start up could required significant regulatory support”* [CLLS]; along with

b) a contribution to the CF as it continues to be *“a key client protection mechanism, contributing to public confidence in the profession”*.

Another private practice firm also noted that:

*“difficult years are not the first year when indemnity insurance premiums are low reflecting low risk of a firm in its first trading year but years 2 and 3 when indemnity insurance premiums rise dramatically (in my case irrespective of the fact that no claims or circumstances have been reported). I don't think it's fair that my practice in its third year should subsidise new entrants”*.

37. TLS pointed out that *“[t]here are vastly different risks and costs associated between a two partner firm and a big commercial organisation”* and that therefore the fee should be calculated on a sliding scale depending on the size of the new operation. TLS also felt that all firms should have an equal



duty to contribute to the CF as “[t]he Fund is an important part of protecting the profession’s reputation. All solicitors/ SRA regulated entities benefit from this collective reputation”.

38. Respondents broadly agreed with the proposed charges for new firms / sole practitioners at first renewal, with some reservations. A sole practitioner noted that “‘scaling up’ could be unrepresentative of actual annual outcomes” and therefore “some mechanism for adjustment by referral to actual turnover is desirable”; and elsewhere “typically new businesses will generate losses initially and calculating the fee on this basis may generate an erroneous result” [CLLS].

39. On the question of mergers, Option 1 (the combined annual turnover) appeared to respondents to be the fairest and also “the most cost effective and easiest way of making an assessment” [Private Practice Firm]. However, some respondents objected that this model would rely on “distorted accounts in relation to new firm” [BLS]; and potentially “the new firm could be charged nearly twice over if the turnover of the merged firm was not equal to the total turnover of the previous firms as sometimes happens in a recession” [SSPG]. For that reason one private practice firm suggested that “once definite figures are known for the year in question the necessary adjustments are made to ensure fairness”.

40. The majority of respondents opted for Option 1 for dealing with splitting entities (combined turnover of the last accounting period), with one private practice firm suggesting the need for a default position when firms fail to respond on the split percentage:

*“I would suggest that this should be to split the figures between those partners who continue to practice. For example, if in a 4 partner firm, 1 partner becomes bankrupt as a result of personal debts and ceases to practice, the turnover should be divided amongst the 3 who continue to practice. This is likely to reflect the reality that the clients of a partner who ceases to practice are likely to go to the remaining partners who continue in practice”.*

If, however, Option 2 was introduced, then one offered suggestion was “the possibility of reconciliation of fees against actual turn-over at the end of the first operating year” [Employed Solicitor].

41. A majority of respondents agreed that some charges should apply to branches of foreign firms in England and Wales, but views differed on the level of these charges, from accepting the proposed 'small flat fee', to suggesting that the fees "*reflect the true regulatory costs applicable to such offices*" [HILS], or "*a fee based on turnover in England and Wales*" [Private Practice Firm].

### **Any other general comments**

Discussion points

16. Are there any other comments you would like to make?

42. Overall respondents were positive about the proposed changes, and as one summarised the position: "*whatever system is settled upon it should be made as simple and therefore as cost effective as possible*" [Private Practice Solicitor].

43. In particular employed solicitors, their employers and those representing this group, welcomed the proposed changes as leading to greater fairness and more equitable distribution of the cost of regulation of the profession. At the same time, however, many of them were concerned about the phasing approach, stating that the system has been "*unfair for many years and phasing only prolongs the issue for an even longer period when it is accepted that reform is urgently needed*" [anonymous].

44. Many, therefore, perceived the proposals as only an initial limited step towards a risk-based approach:

*"The SRA should move more quickly to a risk-based fee charging policy as this would be much more reflective of the actual work undertaken by the SRA and the main purpose of the annual fees. A risk based fee policy is much fairer as the firms that do not practice high risk areas, have sound risk management policies and/or are highly compliant will not subsidise those firms that are more risky and thus attract more SRA time and payment(s) from the Contribution Fund. A risk based fee policy backed by other SRA/Law Society policies and initiatives will inherently encourage the profession as a*

*whole to avoid risk(s) and/or manage it much better. This in the end is what the public/clients/consumers deserve.” [Private Practice Solicitor]*

45. Some other general issues raised included the overall cost of regulation (and ultimately achieving value-for-money), and as one sole practitioner noted: *“[i]t would have been helpful to be given more information about projections of overall regulatory costs over the next 5 or so years”* as this would allow the profession to make more informed decisions on the consultation proposals.
46. Respondents also urged that further considerations should be taken into account when making final decisions in relation to certain sectors of the profession, especially relating to legal aid and access to justice.
47. Equally, large law firms who responded to this consultation raised concerns that turnover did not reflect the SRA’s time, effort and resources devoted to regulating firms, especially those that had invested in modern risk management systems and processes, and so what was being put forward *“does not justify the level of increase being proposed”* to this sector of the profession.

## **Conclusions**

48. This consultation discussed in more detail the rules and processes of how the costs of regulation should be shared amongst those in the profession.
49. The comments and feedback provided in response to this consultation are of great value as they will inform the development of the new fee structure.
50. The third consultation (on an Appeals Process) and further engagement activities will be taking place until the end of March, in order to provide further feedback and seek more in-depth views on the proposed rules and processes of the new funding structure.
51. It is important, therefore, that the widest possible range of stakeholders become involved in the ongoing engagement activities, and especially in providing their feedback to the third consultation. This will help to ensure that all views are heard and that we are provided with the information and evidence on how the implementation of the proposed changes might affect the profession at large and specific groups within it.

## **Appendix 1 (Response from the Law Society)**



The Law Society

### **The Law Society's Response to the SRA consultation 'MOVING TOWARD A FAIRER FEE POLICY' - Second consultation**

**22 January 2010**

# SUPPORTING solicitors



The Law Society

## **The Law Society's Response to the consultation 'MOVING TOWARD A FAIRER FEE POLICY' - Second consultation**

### **Question 1**

**Do you broadly agree with our conclusion that banded turnover is the best model for the firm based fee? If not, please give your reasons.**

Yes. We accept that the administration costs associated with Model 3, which was our initial preference, means that it is not an efficient option.

### **Question 2**

**Do you agree that the split between the individual and firm allocation should be 40/60? If not, please give your reason.**

The Law Society would be in favour of having a 50/50 split at the beginning. A lot of the activities which the SRA regulates are the responsibility of both the individual's behaviour and entity's systems. At the outset it is sensible to allocate costs which could fall either side to the individual PC fee.

The SRA should move gradually towards placing a higher proportion of the fee onto the entity. This smooth the process of change for all those who are regulated and allow the SRA more accurately to judge where burdens should fall.

### **Question 3**

**Do you have any further comments on the proposals in the section dealing with the regulatory fee?**

No

### **Question 4**

**Do you agree with the SRA proposal that the Compensation Fund should only be used and funded to pay**

- **The direct costs of claims,**
- **The costs of handling those claims, and**
- **Any necessary reserves?**

We have no objection to that approach.

### **Question 5**

**Which option for funding the Compensation Fund do you prefer, and why? If you think there is another option, please give details.**

**Option 1: Individual: Flat/Entity: Flat Fee**

**Option 2: Individual: Flat/Entity: Turnover-based (options 2a and 2b)**

**Option 3: Individual: Flat/Entity: based on number of partners/members/directors.**

The Law Society favours option 2, which prioritises the ability to pay of sole practitioners and small firms. As stated in our response to the first consultation, one of the main factors which should determine the amount a private practice firm contributes to the Fund is the number of fee earners. It is not acceptable to load contributions onto sole practitioners and those who work in small firms, the vast majority of whom are no risk to the Fund.

However, this issue is less significant than it might have been, first because practitioners and practices will from 2010 only be contributing to the direct costs of the Fund; and secondly because the SRA's proposed approach to introducing the new arrangements (with which we agree) will ensure that the relative shares of the overall regulatory burden (practising fees plus compensation fund contributions) are borne fairly by firms of different sizes and remain unchanged from the current apportionment.

### **Question 6.1**

**Do you have any comments with regards to the suggested turnover bandings and rates?**

The suggested turnover bands seem to be sensible.

#### **Question 6.2**

**What do you think about the approach to keeping the proportion paid by firms of different pattern bandings as close as possible to the current model?**

We agree with this approach. There is no evidence which suggests that there is a better way of doing it.

#### **Question 7.1**

**Do your work examples reinforce and reflect the above?**

Not applicable.

#### **Question 7.2**

**Does the information we have provided (i.e worked examples) help you in assessing how your firm might be affected? Is there any other information you would find helpful?**

Not applicable.

#### **Question 8.1**

**What might be the impact (both positive and negative) on your firm if it is a one-stage process?**

Not applicable.

#### **Question 8.2**

**What might be the impact (both positive and negative) on your firm if it is a two-stage process?**

Not applicable.

#### **Question 8.3**

**Can you think how else a one-stage or a two-stage process might affect the profession?**

At the introduction of this new charging scheme we believe that the one-stage process is the most appropriate method of calculating entity fees. This will give firms plenty of notice of the amount they will be charge and the SRA time to work out what amounts should be attributed to each band.

#### **Question 9**

**Do you think that we should charge additional fees to encourage firms to provide the required information on time? What model do you think is more appropriate for the calculation of such additional fees?**

Yes. At the very least any additional cost which is incurred by responding late should be covered by those who miss the deadline.

Of the options available the Law Society favours option 3 – a proportion of the fees payable. It is the simplest amount to calculate and reflects ability to pay.

#### **Question 10**

**Do you agree with the rationale of charging UK firms with branches outside of England and Wales a small flat fee in relation to each branch to cover the cost of regulation, or do you think this cost should be borne by the whole profession through regulatory fees?**

Yes. The monies raised should cover the costs incurred of regulating these entities.

#### **Question 11**

**Please give us your views on whether you support our proposal to charge new firm/sole practitioners in their first practising year:**

- **A flat not-pro-rated application fee of £180 for new firms, and £90 for sole practitioners.**
- **No further contribution to the Compensation Fund.**

If the SRA wants to charge a fixed fee it should be on a sliding scale depending on the size of the new operation. There are vastly different risks and costs associated between a two partner firm and a big commercial organisation who may want to turn their legal services department into an ABS. Each new entity will have a business plan which should give the SRA an idea about the size of their operation.

We are against there being any Compensation Fund holiday. It is the equal duty of all firms to contribute towards the Fund. The Fund is an important part of protecting the profession's reputation. All solicitors/ SRA regulated entities benefit from this collective reputation. On a practical note, responsible entities should be able to make a contribution from day one.

#### **Question 12**

**Please give us your views on whether you support our approach to new firms/sole-practitioners at first renewal:**

- **New firms with turnover data for less than three months will provide an estimated turnover value similar to that which is provided to indemnity insurers (but only with England and Wales turnover).**
- **If turnover data is available for a part year (i.e more than three months), this should be scaled up pro rata.**

The Law Society supports this approach.

#### **Question 13**

**Please give us your views on how the SRA should approach setting fees for firms that have merged, and comment further on the following options proposed by us on what these fees should be based on.**



- **Option 1: the combined annual turnover for the last accounting period for the different firms prior to the merger.**
- **Option 2: the actual turnover generated since the merger which will be scaled up to reflect the yearly gross fees of the merged firm.**

The Law Society favours Option 1.

#### **Question 14**

**Please give us your views on how the SRA should approach collecting fees from firms that have split part way through the practising year, and comment further on the following options we have proposed.**

- **Option 1: Charge the splitting entities their corresponding stakes based on the combined turnover for their last accounting period. The onus is on the profession to establish the split percentage.**
- **Option 2: Charge the splitting entities on their actual turnover generated since the split, which will be scaled up to reflect the yearly gross fees of the new independent firm.**
- **Option 3: Charge only the firm that retains the majority of the business post split for the entire turnover.**

The Law Society favours Option 1. The entities should be able to agree amongst themselves what percentage of the fee each new entity should pay. If the SRA needs to arbitrate in such a matter they should add administration costs onto the amount owed.

#### **Question 15**

**In line with the principles of fairness, do you agree that the SRA should adopt the same approach of charging a small flat fee for each overseas office for foreign firms with branches in England and Wales? Are there any other options that you might regard as reasonable?**

Yes. Overseas offices should reimburse all regulatory costs that are associated with their operation. It would be unfair for others in the profession to subsidise them.

#### **Question 16**

**Are there any other comments you would like to make?**

No