Moving towards a fairer fee policy

Report on responses to consultation paper 19

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Introduction

1. The consultation paper, *Moving towards a Fairer Fee Policy*, was part of the first phase of an engagement strategy designed to collate 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 also dealt with new ways of setting compensation fund contributions.

2. The consultation paper was launched on 30 June 2009 and closed on 28 September 2009. It was open for comments for twelve weeks. It posed 24 questions on the various proposals and covered the high level principles for the changes to the funding structures, identified key options which could be used as the basis for determining fees and contributions, and whether current discounts and special cases should be maintained.

3. This report will present analysis of the feedback received and provide the key points made by respondents. We received 49 responses to the questionnaire along with 20 general responses by email and post. All of the responses have been taken into account and fully considered.

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

5. The responses were submitted by, or on behalf of, a range of local law societies, representative bodies as well as individuals from different sectors and law firms of varying sizes.

   These included:

   - AdviceUK
   - Bar Standards Board (BSB)
   - Birmingham City Council
   - Corporate and Legal Services
   - General Medical Council (GMC)
   - Institute of Legal Executives (ILEX)
   - Lawyers in Commerce and Industry

- Legal Services Commission (LSC)
- Legal Services Ombudsman for England and Wales
- London Borough of Islington
- Refugee and Migrant Justice (RMJ)
- Risk & Compliance Group
- Solicitors in Local Government (SLG)
- Test Valley Borough Council
- The Advice Services Alliance (ASA)
- The Association of Council Secretaries and Solicitors (ACSeS)
- The City of London Law Society (CLLS)
- The City of Westminster and Holborn Law Society (CWHLS)
- The Hampshire Incorporated Law Society (HILS)
- The Judicial Appointments Commission (JAC)
- The Law Society (TLS)
- The Leicestershire Law Society (LLS)
- The Sole Practitioners' Group (SPG)
- The National Trust for Places of Historic Interest or Natural Beauty
- West Wales Law Society
- Winchester City Council
- Warwickshire County Council
- 10 private practice firms
- 32 individuals

6. In brief, we found broad agreement on:

   - the principles and objectives driving the new fee policy
   - the turnover model for the firm component of the regulatory fee to be the preferred option of most consultees
   - the Compensation Fund to continue to be a means of providing the public with confidence in the profession, and to be based on individual and entity component contributions
   - the need for further assessment of the impact on the profession to continue in order to reveal any significant positive and negative effects

   The main concerns were:

- how the specific principles and objectives of the new funding system will be interpreted in the future
- the need to provide the profession with more detailed information on the proposed fee structure (including worked examples)
- the need to further develop the Compensation Fund model to be fairer for the profession

7. This consultation paper was the first step in the process of gathering views on how to develop a fairer fee structure. In the second consultation paper, which is going to be released in December, we will explain our initial conclusions, give more examples of the impacts and will continue to look for feedback and comments on the proposed new fee structure.

Responses to the questions

Principles and objectives of any new fee structure

Original 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?

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?

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?

8. An overwhelming majority of respondents welcomed and were supportive of the proposed principles and objectives of any new fee structure as potentially leading to a fairer system. One of the primary issues raised referred to the clarity of how the specific principles would be interpreted, and how the SRA would deal with any potential conflicts of their aims or diverging interpretations. The Legal Services Commission [LSC] noted:

   "[t]he challenge will be to interpret the principles and achieve a balance between them, especially where they have the potential to conflict".

9. Many submissions observed that 'double-counting' and 'double-charging' should be carefully avoided; also any decision taken with regards to the new funding structure should aim at striking a balance between the relative costs of regulating, ability to pay and level of risk caused by individuals/firms.

   "It is essential that fairness prevails, and firms are not penalised in any way purely due to their size and structure. Furthermore, there should be no element of charging twice". [the Sole Practitioners' Group]

10. These concerns are being taken into consideration throughout the development of the new fee structure. It also became evident that certain principles and objectives upon which the new fee structure will be based, may need to be weighted differently to allow for a phased approach. One of the difficulties that will need to be dealt with is that even though all of the principles and objectives consulted upon are important, nevertheless, they are of different influence on the decision-making processes.

11. Most respondents agreed that all solicitors should contribute towards the overall cost of regulation, including sole practitioners being charged a firm fee under the same fee structure as a firm with multiple partners and/or fee earners, because there are certain intrinsic benefits of the regulatory system for the profession as a whole. It was, however, undecided and widely debated among the respondents as to whether the individual component of the regulatory fee should be equal for all in the profession, or whether it should vary for different types of solicitors working in different sectors. Some respondents strongly expressed the need for certain types of solicitors to be charged reduced fees (such as in-house, public sector employed

solicitors, or solicitors working for Registered Charities and Non-for-Profit (NfP) organisations).

The Advice Services Alliance (ASA) expressed the concern that *"the position of NfP solicitors is very different from those in private practice"* and therefore it would be *"unfair for solicitors working in the NfP sector to pay the same individual (practicing) fee as those working in other environments"* as this sector *"is generally regarded as having a low risk",* and *"generally accountable to a number of other bodies including other regulators […] and funders […]".*

12. However, as Winchester City Council suggested:

    "[p]rovided the individual fee is sufficiently low, it would be uneconomic to seek to distinguish between different types of solicitor".

    Moreover, introducing the same fees for all solicitors *"would allow consistency and predictability"* and *"would also ensure ease of administration".* [The Institute of Legal Executives (ILEX)]

13. Clearly, there is a balance to be struck. It is necessary to draw a line between splitting costs incurred when regulating various types of individuals and firms, and factoring the ability to pay principle in the model in order to achieve a fairer system. The fee should be set at a level which does not prohibit it to continue to practice and therefore it is crucial that any fee level is realistic.

14. It is evident, therefore, that whatever new system we introduce, it would need to be not only fairer but also reasonable. A phased approach was therefore the preferred option amongst respondents. The main reason was to ensure that firms are not suddenly faced with unexpectedly large bills which they are unable to pay. There was a general consensus, however, that the phased approach should last no longer than two to three years, yet ensuring that:

    "particular parts of the profession are not prejudiced immediately but are instead given time to plan for the changes". [Risk & Compliance Group]

    However, strong views in contrary to this proposal were expressed by the Association of Council Secretaries and Solicitors (ACSeS), which received endorsement by a number of local councils and in-house public sector solicitors:

    "[t]he fees have been heavily unbalanced and unfair for many years and it is entirely inappropriate and unfair that local government should continue to subsidise private practice for any further period of time".

15. The question of whether certain reductions (discounts) should remain or could be removed if the individual fee was set low enough, did not receive a clear response. This issue, therefore, will be looked at in more detail in the follow-up consultation as it was felt by a number of respondents that there was insufficient information provided (especially the proposed level of the individual fee) in order to give any definite answer:

    "[p]rovided that the individual fee becomes considerably lower, it is likely that the costs of collecting a more graduated fee would outweigh the benefits to individual practitioners." [LSC]

    "In the interests of fairness, it is unlikely that special cases and reductions can ever be ruled out." [Risk & Compliance Group]

16. The case of using size of business as a proxy for benefits of regulation was affirmed by an overwhelming majority of submissions:

    "unfairness of using turnover as a yardstick is more than weighted by the practical benefit and certainty provided by using a simple and ascertainable figure as a basis for calculation." [City of Westminster and Holborn Law Society]

17. That, however, was perceived often as an intermediate solution until sufficient data is collected to verify where the different activities of firms have a measurable impact on the amount of regulation required, as:

    "the suggested approach seems to be largely based on a perceived risk, rather than on actual failing of a firm" and *"in fact none of those factors* [annual turnover or number of fee earners] *may have contributed to the firm's level of risk or have caused additional costs to be incurred by the SRA".* [ILEX]

    Size, therefore, should only to be considered as one of the indicators of the actual cost of regulation, alongside complaints history, demonstrable management systems, source of funding and firm profile. As expressed by some respondents:

    "[h]igh turnover may indicate a high level of activity, but firms with greater turnover have more funds to allocate to risk-management systems than firms with low turnover, and would therefore generally pose less risk to the public". [Private Practice Firm]

    "[l]arger firms are more likely […] to have processes and procedures in place to manage risk issues". [Refugee and Migrant Justice]

18. Although the SRA is developing risk-based regulation, this does not mean that any future model will apportion the fees solely on the basis of the regulatory risk presented by firms as this is not necessarily indicative of the level of regulatory activities or costs incurred (as has been also concluded by the FSA[1]).

19. Some respondents also expressed an interest in being provided with a breakdown of regulatory and non-regulatory (permitted activities under Section 51 of the Legal Services Act 2007) activities within the fees contribution. In terms of the allocation of non-regulatory costs, one of the respondents pointed out that further clarification on what the proportion of fees covers the non-regulatory activities would be helpful in clarifying the issue, and another one suggested to follow the same model as for regulatory activity as:

    "[i]t seems to us to be less complicated and more transparent if the attribution of costs is the same for both activities". [Private Practice Firm]

    This information will be provided as part of the more transparent fee structure, as it is a requirement of the Legal Services Board, and will be outlined further in the follow-up consultation paper.

Preferred Models

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?

[1] 'A New Regulator for a New Millennium', available at: http://www.fsa.gov.uk/pubs/policy/p29.pdf

20. The vast majority of the respondents agreed with the wording of our definition of 'turnover':

    - Gross Fees: including "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.

    According to the LSC, it *"seemed in line with definitions used elsewhere, and is both appropriate and easy for firms to understand"*. It was repeatedly emphasised that it should follow or remain as close as possible to that of the Solicitors Indemnity Insurance Rules. However, one common objection was that Notarial Fees should be excluded from the turnover figures submitted to the SRA, although they were included in the definition for the figures to be provided during this year's renewal process.

21. The overwhelming majority of respondents agreed that it would be either '*Easy'* or '*Straightforward'* to identify and collect information on the number of FTE fee earners working in their firms, but in some situations it may lead to variations in interpretation, and also be open to manipulation, for example in situations such as where:

    "significant numbers of dual role people are engaged – e.g. secretaries who are in transition from a clerical role to that of a fee earner" [Hampshire Incorporated Law Society]; or as expresses elsewhere

    "the term 'fee earner' is not commonly used in the NfP sector and doesn't reflect the aims of our organisations".[ASA]

    The definition would therefore have to be fully developed in order to ensure that the data collected reflects what is required by the SRA, and as the Risk & Compliance Group emphasised:

    "[t]he earlier […] the SRA can indicate how they want this information to be collated, the easier it will be for firms".

22. The model felt by most respondents to be the fairest for the profession was Model 2 (where firms are banded according to annual turnover). This was followed by Model 3 (combined) and the least preferred option selected was Model 1 (fee earners).

23. The main advantage of Model 2 perceived was clarity of data required and simplicity in validating the information provided, or as summarised by the City of Westminster and Holborn Law Society:

    "It is the simplest and most practical model, based on a tried and tested formula. Keeping things simple should have the overall effect of allowing the regulated community to plan effectively and should minimise administration costs".

24. Similar logic was evident in comments to Model 3 which although favoured by the Law Society (TLS) was seen by others as too complex to be effectively monitored and potentially more costly in practice:

    "the least workable in practice" [City of Westminster and Holborn Law Society]

    "it would be unduly complex and [would] involve extra costs to manage monitor and maintain". [Private Practice Firm]

25. Model 1 (entity fees based on firms paying a flat fee per FTE fee earner) was seen as the least preferred option as it could potentially lead to certain firms being penalised for the number of staff employed (including trainees), and not necessarily reflective of the risk involved, costs associated with regulation, or in conformity with the ability to pay principle. ILEX pointed out also that many non-solicitor fee earners are already subject to regulation by other approved regulators, and therefore this proposal could lead to:

    "dual regulation and a double levy in respect of regulatory activities, [which] *does not appear to be proportionate, fair and in the public interest".*

26. Many of the respondents emphasised they would like to see more details on how these models would work in practice in order for them to make a more informed decision about the models, and how they may impact on them:

    "[w]ithout illustrations of possible figures […] it is impossible to say" [Private Practice Firm]; or elsewhere

    "it is too soon to say, more examples need to be provided". [Private Practice Firm]

Special Cases

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?

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?

27. Similarly the issue of new firms, overseas offices, and firms that spilt or close, proved to be difficult to give any clear-cut answer until the model of the new fee structure is chosen; nevertheless, the further work here should be equally guided by the same principles of 'fairness' and 'ability to pay'.

28. The majority of respondents agreed to the principle of having a fixed firm fee for new firms, but stressed that this was dependent on its affordability for new entrants as *"an unnecessary barrier to entry"* [TLS] should be avoided.

29. Some suggested the need to differentiate between new firms based on their size and complexity, as potentially requiring a different type of regulation, and as such they should be charged accordingly. Respondents also noted that it would not be impossible for a new firm to provide an estimate of its future turnover, and as highlighted by the LSC this information is required anyway as *"part of its business planning"*.

30. Although a large portion of respondents agreed in principle that there should be no reimbursement for firms which are closing down, some expressed concerns that where the closing firms (which have already paid a firm fee for that year) result in the creation of a new firm, these should either:

    1) be offered a discount or credited back the fees paid, *or*
    2) be offered a relocation of the fees if the change occurs within the first six months, *or*
    3) be charged only the administrative fee which would reflect the additional costs of registering them again.

31. A number of respondents expressed their confusion with regards to questions 15 and 17, which surrounded the definition of the term 'overseas offices', and whether it related to overseas offices of UK firms, or overseas firms with offices in the UK. In fact the two questions were included in error and were intended to cover the issue of firms who have branch offices in other jurisdictions. The follow-up consultation paper will include proposals on how to deal with such offices.

32. Although the majority agreed that overseas offices should be charged an additional fee to cover regulatory costs, these should not deter small firms from operating internationally. The majority agreed, with a few concerns, that the level of such fee should be realistic and not make it exceedingly expensive for sole practitioners to practice.

33. The respondents were in agreement that if regulating overseas offices does indeed generate additional costs, these should not be spread across the profession but be covered by firms that have offices overseas. Any additional fees, therefore, should reflect this but at the same time should not be excessive.

34. It was pointed out that in the current economic climate there might be an increase in mergers and splits activities, which could *"impact on the predictability of the income for the regulator"* [LSC], and so necessary attention should be paid in developing an appropriate scale of charges to reflect the reality.

Compensation Fund

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?

35. The widely held view among the respondents was that the Compensation Fund (CF) should continue to provide the public with confidence in the profession, and that it is a *"necessary burden"* that *"enhances the reputation of the profession".* [City of Westminster and Holborn Law Society]

36. Introduction of an entity component to the CF contribution was seen as the most favourable option, with the majority agreeing that all firms should contribute regardless of whether they hold client money or not, and similarly with all solicitors contributing towards its costs.

37. However, the views were divided on the proportion of the split for individual and firm contribution to the CF between:

1) those favouring following the same split as for the regulatory fee for the reason of simplicity, and as it *"seems a reasonable choice"* [Legal Services Commission]; and

2) those favouring for it to be based more on the risk and costs that exist, therefore, with firms taking higher burden than individuals as holding greater responsibility for clients' accounts.

38. It was perceived that potentially a *"relatively nominal amount"* would be required from all solicitors to *"establish the principle"* [The National Trust for Places of Historic Interest or Natural Beauty], with the remainder to be drawn from individuals and organisations that hold client funds as the very fact of holding client money *"means that there is a possibility of a claim"* [TLS].

39. The factor determining the amount that a private practice firm holding private money contributes to the CF was set evenly between '*Size*' and '*Risk*' as both contributing to a fairer allocation of costs.

40. The majority of comments suggested that both factors are important and should be looked at as relevant variables, with some suggesting that if a firm is *"properly managed in accordance with the Code of Conduct, and with proper systems, controls and processes in place then it should not cause claims on the Compensation Fund"* [Risk & Compliance Group] regardless of the size; with some others accepting that if there is no adequate system of measuring risk, then size should be used as next best indicator.

41. However for both options it is not possible to avoid *"subsidising the impact of those who are incompetent and/or dishonest"* [TLS] by those posing relatively low risk, i.e. *"an honest sole practitioner, an in house lawyer or a partner in a large firm"* and, therefore *"it is fair that all those who wish to call themselves a member of our profession should contribute equally to the compensation fund"* [City of Westminster and Holborn Law Society].

42. One respondent highlighted also the need to improve information and education to existing and prospective solicitors on the Compensation Fund as the first step to improving the regulatory activities.

Impacts of the new regime on private practice

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.

43. The majority expressed the view that there is likely to be some form of impact on particular groups, referring both to the positive and negative effects. A significant number of respondents suggested that most likely small firms and sole practitioners will experience the most significant negative impact in favour of larger firms, which could *"result in less investment available to small firms to make any substantial steps towards growing"* [Private Practice Firm].

44. Various respondents pointed out also that BMEs, primarily female practices and small local firms might be negatively affected, and therefore the proposals *"may have an unintended consequences on equality and diversity issues"* [ILEX].

45. Similar concerns were raised with regards to charities, NfPs and legal aid firms which could potentially *"make them vulnerable to some of the proposals outlined in the consultation"* [LSC].

46. One respondent, focusing on the positive effects of these proposed changes, noted that *"[i]t would appear to affect all groups depending upon their 'risks'. This is to be applauded"* [Individual Solicitor].

47. These issues will be further investigated to ensure that any unjustified adverse impact is eliminated or minimised. In shaping these proposals, we will continue to make a full assessment of the impact that is likely in certain areas. We will continue the assessment until the policy is introduced, and once launched we will review this to address any impact identified and to verify whether the policy does, or is likely to have, significant negative or positive consequences for particular equality target groups.

Conclusions

48. This consultation discussed for the first time how the costs of regulation should be shared amongst those in the profession. The focus of this consultation was on the principles and objectives driving the new fee policy.

49. The questions we consulted on were the first step towards a more detailed evaluation of the new fee structure. This initial feedback provides a baseline for further development of the new fee structure, and therefore the comments and feedback given in response to this consultation are of great value.

50. The responses have been instrumental in verifying the preferred model for firm component of regulatory fee, and in helping to develop further proposals on the charging principles. Consultation responses helped to reveal potential impact of the proposed changes on particular groups and sectors, as well as highlighting areas which will require further thought and consideration.

51. Further consultation and engagement activities are going to take place until the end of this year, including a follow-up consultation paper, which seeks to gauge more in-depth views on the proposed rules and principles of the new funding structure.

52. It is important, therefore, that the widest possible sets of stakeholders become involved in the ongoing engagement activities, and especially in responding to the follow-up consultation. This ensures that all views are heard and that we are provided with the evidence on how the proposed changes might affect certain groups.