

Moving toward a fairer fee policy

Transitional arrangements

A third discussion paper from the Solicitors Regulation Authority consulting on fairer fee policy

Legal Services Act: New forms of practice and regulation

Consultation paper 22

March 2010

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Introduction

1. The way in which the cost of regulation is currently allocated among the profession through the practising certificate fee leads to anomalies and unfairness. Changes to the Legal Services Act 2007 have created the opportunity to develop a fairer system through the introduction of entity-based regulation.
2. The need for change was explained in *Moving toward a fairer fee policy* (Legal Services Act: Consultation Paper 19) published in June 2009 and further discussed in *Moving toward a fairer fee policy: Second Consultation* (Legal Services Act: Consultation Paper 21).

3. Following the [feedback](#) from both consultations and further stakeholder engagement, the SRA Board has concluded that a banded turnover model (turnover refers to gross fees as defined in [consultation paper 21](#)) offers the fairest structure. The SRA Board has also concluded that for 2010 we should use the turnover figures collected from firms during the 2009 renewal process. The benefit of this approach is that it will enable the SRA to give firms an early indication of the banding and fees to help firms in their financial planning.
4. The drawback of using historic turnover data is that where firms have experienced an unusually large reduction in turnover during 2009/10, the firm's current level of activity may not justify a fee set on previous turnover. In the first year of operation of a new scheme an unexpected increase in fees, coupled with a decline in activity may warrant a process to moderate the impact, particularly on small firms.
5. Most firms should be able to plan for fluctuations in their fixed costs, given sufficient warning. However, some firms will face a considerable overall increase in the first year of change. This will be fair in so far as it reflects the level of activity. However, if their more recent turnover is significantly lower, then a fee based on historic turnover may give rise to financial difficulty. For that reason, the SRA Board believes that it should consider providing a transitional moderation process for certain firms to facilitate a smooth transition to the new funding arrangement.
6. The purpose of this paper is to consult on a proposed transitional fee moderation process, and to identify eligibility criteria which are both fair to firms who may need to seek moderation and to all other firms who will, as a result, have to bear a slightly bigger share of the cost. Such a process also needs to be simple, transparent, economic and efficient to administer. The transitional arrangements proposed as an option will not be a general appeal process open to all who may think the new structure has had an unfair impact on them. We will also be consulting on the option to not run any transitional arrangements.
7. We also include at the end of this paper a revised proposal as to how we intend to charge new firms. Consideration of the feedback on the options on new firms has resulted in the development of a different proposal.
8. As with the previous consultation papers, our eight broad principles will also apply to the fee moderation process. The principles are as follows:
 - be fair to fee payers,
 - be efficient and economical to administer,
 - ensure a predictable income to meet the cost of regulation,
 - be stable—charges should not vary considerably year on year,
 - be as simple as possible—to enable the regulated profession to predict their likely fees,

- be based on data that can be verified,
 - ensure that, where possible, the costs of processes that are not of general application should be borne by those making such applications, as far as possible, on a cost recovery basis, take some account of the ability to pay, in particular in relation to small and new businesses—fees should not be a deterrent to new entrants.
9. This consultation will last for six weeks. The shortened consultation period is required to ensure that we can reach conclusions and implement the changes in time for the 2010 renewal process. Although this is our third consultation we will continue to seek feedback and ensure sustained engagement with all relevant stakeholders. Informal engagement has been taking place since June 2009, and will continue alongside this consultation paper.

Context

10. In the paper on *Moving toward a fairer fee policy* where the preferred banded turnover option was discussed at length we did not foresee the need to implement transitional arrangements as we believed (and still believe) that the new fee structure is fair (paragraph 87). The banded turnover model accounts for how much income a business generates, and is a reasonable indicator of a firm's ability to pay. We plan to provide early warning to firms who will be experiencing a significant increase in fees, therefore allowing them to plan their outgoings accordingly. However we recognise that smaller firms may still find it challenging to cope with the change from an ability to pay perspective.
11. With the new funding structure being driven by principles such as fairness, the ability to pay, and stability of fees from year to year, we wish to consult on options for a transitional fee moderation process.
12. Feedback from the profession has supported a one-stage renewal process which uses historic turnover data as it reduces administrative effort and is easy for the profession to calculate. It also accounts for issues surrounding prolonged debtor periods which are predominantly experienced by smaller practices.
13. We currently believe that we need this transitional fee moderation process for this year only, in order to mitigate the impact of using historic turnover as the basis for calculating the firm fee, recognising that for this year of the new system, firms will not have been fully aware of the new fee structure basis and could not financially plan ahead. In future years, the expectation is that firms will be able to better forecast what their fees will be and budget appropriately. We will however review the need for such a process in the future.

Transitional arrangements – Options

14. We have considered the eight principles listed in the introduction, in order to determine the most appropriate approach and have considered the following options:

Option 1: no fee moderation process

One option is that there should be no fee moderation process. Any fee moderation process will have the negative consequence of increased costs for the rest of the profession as a result of a firm being granted reduced fees. Also, any fee moderation process will result in some cost for the profession because the SRA will need to establish a process, unless the cost of any fee moderation process is passed directly to the applicant.

Option 2: criteria-based fee moderation process

The other option is to establish a predetermined set of conditions for a fee moderation process which reflect the ability to pay. Such a process would not involve any subjective assessment, but would recognise that some firms may be adversely affected by a significant fall in turnover. Those who apply and fulfil the complete set of criteria would receive a calculated reduction to their fees. There would be no discretion involved in the process, resulting in a robust, objective and transparent system which is both efficient and economic to administer.

If the preferred option is that we should develop a process based on Option 2, we propose the criteria and process as set out below.

Criteria-based fee moderation: detailed proposal

15. Applicants would be required to satisfy all conditions in order to qualify for a reduced fee which will then be calculated on a pre-determined basis.

i. Turnover from most recent closed annual accounts is below £500,000

We envisage firms above this threshold to be capable of funding their new fees; this could be through either using working capital or obtaining credit from financial institutions. See paragraph 16 below for consideration of exemption to this criteria for Legal Aid firms.

ii. The total fees (including Individual and Firm-based Regulation and Compensation Fund contribution) for 2010 based on the turnover figure submitted in the 2009 renewal cycle will be at least 50 per cent higher than the total fees paid by the firm in 2009.

This limits the process to those whose ability to pay has been affected by an unexpected significant increase in their fees.

iii. Turnover from most recent closed annual accounts has reduced by at least 30 per cent compared to the figure submitted to the SRA in 2009.

This will account for those issues which arise as a result of using historic turnover data but needs to be set at a level which is reflective of the change in overall fees across the whole profession. The SRA will take steps to validate this information in order to ensure it is accurate.

16. We are considering removing or changing the below £500k of turnover threshold requirement (criteria i.) for those firms who generate at least 50 per

cent of their turnover through legal aid work. This is because some members of the profession have raised concerns about the impact of the new structure on firms with a high percentage of legal aid (these firms often have high turnover/low margin) and a possible impact on access to justice. The other criteria above would still apply.

17. We currently propose not to require firms to demonstrate significant financial hardship. To apply a discretionary approach requiring the SRA to assess or measure 'significant financial hardship' would have elements of subjectivity and would require a bureaucratic case-by-case system which would add costs, risk and delay.

Fee determination

18. We will set the regulatory firm fee for an applicant who meets the above criteria by using a turnover figure that is halfway between the most recent annual accounts and that submitted to the SRA in 2009. This system ensures that there is still a move towards paying the appropriate fee under the new systems for the firms concerned, while also minimising administrative effort and providing an objective system.

Application process

19. Should the SRA decide to operate the transitional fee moderation process, those firms who wish to be considered for a fee moderation must make an application using a prescribed SRA 'Fee Moderation Request' form, which will capture all relevant eligibility criteria. An online calculator will be provided to support firms in assessing whether they are eligible. All applications must be received between 1 July and 31 August. The time limits for filing a fee moderation request will be strictly enforced. The reason for this restricted window for fee moderation is to minimise disruption and running costs, which would be significant if it were to run alongside the renewal process, increasing complexity and operational risk.
20. In line with the principles of fairness, the SRA would propose to charge applicants who want to be considered for fee moderation, a flat fee of £150 to re-coup the operational costs of processing an application. This is consistent with the principle that where the costs of processes that are not of general application are undertaken, these are borne by those making such applications.
21. The SRA proposes that the applicant will be informed of the outcome of the fee moderation process within a timescale to be agreed. As the process is not based on the exercise of discretion, the outcome of the process will be final.

Impact across the profession

22. If we do not have transitional arrangements, there is no financial impact on the profession as a whole, but those small firms who experience a significant increase in fees and have experienced a significant reduction in turnover may not have an ability to pay in this first year.
23. If we do have the criteria based fee model approach, then with the thresholds that we have set, there are likely to be around 3 per cent of the profession

who are eligible for a moderation of their firm fee, before taking into account the criteria of a drop in turnover in excess of 30 per cent (we are unable to determine what proportion this will be in advance).

24. Of the firms experiencing an increase in fees greater than 50 per cent:
 - a. approximately 250 firms had turnover under £500k; and
 - b. approximately 30 firms have 50% or more of their turnover derived from legal aid activity and also have a turnover over £500k.

25. Any impact analysis at this stage must be based on assumptions. If we assume an average drop in turnover of 50 per cent and that all of the 280 firms above will have experienced a drop of at least 30 per cent, then that would result in an overall fee burden shift on to the rest of the profession of £160k. It is unlikely that all such firms would have qualified for fee moderation as it would be unrealistic to assume that all of these firms will experience a drop in turnover of at least 30 per cent compared with their previous year. Running a fee moderation process would have some implications for operational administration effort and costs however, as long as there is an application fee for the fee moderation process, this should only affect the applying firms.

New firms/charging structure

26. There were mixed views on the SRA's proposal to charge brand new firms a small fixed fee of £180 per firm and £90 per sole practitioner to cover the cost of handling applications. While marginally more agreed with the proposal, others disagreed with this approach and felt that fees should be realistic and should not be subsidised by other members of the profession. Having reconsidered in the light of the responses, the SRA now proposes that an additional regulatory firm fee of £1,000 per brand new firm should be charged to cover the additional cost of regulation (this would be pro-rated across the year so that if a firm started half way through the year, they would pay £500). This approach is considered fairer as the amount of expected regulation and new entrant risk within an uncertain economy is better reflected in these fees.

Equality and diversity

The SRA is committed to promoting equality and diversity within the solicitors' profession, and provide leadership in ensuring that this is a central component to all regulatory policy and activity.

One of our strategic objectives is to ensure that those joining the profession come from a wide range of backgrounds and experience. We also have a legal obligation to show that our policies and regulations are fair and that they are not directly or unjustifiably indirectly discriminatory.

If individuals from particular backgrounds are in any way disadvantaged by a policy, we need to be able to demonstrate that the policy is a proportionate means to achieve a legitimate aim.

The SRA will need to demonstrate fairness and non-discrimination by undertaking equality impact assessments (EIA) of proposed changes. EIAs allow us to identify and consider the impact of our policies on particular groups, and manage risk more effectively.

An equality impact assessment of the proposed changes on the new fee structure has been conducted in order to gain an understanding of how these changes may affect particular groups. This has been, and will continue to be, achieved through engagement activities with the stakeholders to ensure that

- implications of the proposed changes on different groups are considered,
- any adverse impact is minimised and not discriminatory for particular groups,
- ways in which the proposed changes can promote equality are further examined.

Discussion points

Question 1

Which approach do you prefer and why? If you think there is another option, please give details.

- **Option 1: no fee moderation process**
- **Option 2: criteria-based fee moderation process**

Even if you state a preference for Option 1, please comment on the following questions so that your views can be considered should Option 2 be implemented.

Question 2

Do you agree with the criteria proposed for the criteria-based fee moderation process in paragraph 15?

Question 3

What is your view with regard to having an exemption/special provision for firms with 50 per cent of their turnover derived from legal aid work? (Paragraph 16)

Question 4

Are there any other objectively measurable criteria that should be included, for example, to demonstrate financial hardship? (Paragraph 17)

Question 5

What is your view with regard to the proposed fee determination approach? (Paragraph 18)

Question 6

Please comment on the impact of the proposal to run an application window between 1 July and 31 August.

Question 7

What is your view on the proposed processing fee of £150?

Question 8

Are there any other circumstances where allowances should be considered, whether in addition to the currently proposed criteria or as an alternative?

Question 9

What is your view on setting a pro-rated regulatory firm fee for brand new firms/sole practitioners in their first year of practice of £1000?

Question 10

Please indicate any impact of the proposals that you perceive on special interest groups that should be fed into the equality impact assessment.

Question 11

Are there any further comments that you would like to make?

How to respond

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

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

Submission deadline

The deadline for responses is **16 April 2010**.