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By email only

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Dear Matthew

IPReg response to LSB consultation on revised PCF rules and guidance

This letter sets out IPReg's response to the LSB's proposed changes to the rules and guidance governing applications for approval of practising fees.

We welcome the fact that the LSB recognises the need to review the PCF approval process which has been in place for a number of years. However, we are concerned that the LSB is missing an opportunity to simplify and streamline the process and make it more targeted and proportionate. There is a cost to all regulators (and therefore to the regulated community and, ultimately, consumers) of compliance with the LSB's rules and guidance - and the added complexity of the proposed guidance and rules will increase those costs.[1] In particular, we would urge the LSB to implement principles-based regulation of the PCF process and to move away from a reliance on detailed, prescriptive rules; this would leave regulators with the flexibility to determine how they comply with those principles in order to achieve the outcomes that their Boards want to achieve. This would also be consistent with one of the CMA's recommendations in its report on Regulation and Competition published in January 2020. [2]

We realise that the Legal Services Act (**Act**) (section 51(6)) requires the LSB to make rules about PCF applications, but we do not consider that the nature and extent of the proposed rules is justified by the evidence that the LSB has provided in the consultation document. In addition, the type of information required frequently encroaches on issues that are properly the purview of regulatory boards and not the LSB.

Although there is a significant (in our view too much) amount of detail in the proposed rules about the form and manner in which applications must be made and the material that must accompany applications (a requirement of section 51 (6)(a) of the Act) and the consultation process that regulators must undertake (a requirement of section 51(6)b) of the Act), in our view the proposed rules do not set out clearly the procedures and criteria that the LSB is going to apply (a requirement of section 51(6)(c) of the

[1] Longer rules will inevitably require additional guidance and this is what is now being proposed. By way of example, the current guidance runs to around 3490 words – the proposed new guidance runs to around 9730 words. The current rules consist of around 1215 words and the proposed new rules run to around 2250 words.
[2] See in particular paragraph 7.13(a)

Act) when determining whether to approve the level of a PCF. The list in Section K (Decision by the Board) draft rule 31 does not contain any information about procedures or criteria that the LSB will use. It simply states:

> *When making an application under Rule 9 an approved regulator must satisfy the Board that:*
> *a. the approved regulator has complied with these Rules and had regard to the Guidance;*
> *b. the approved regulator will only apply the amounts raised from the practising fee for one or more of the permitted purposes;*
> *c. any increase in the fee, or any part of the fee, is reasonable and proportionate;*
> *d. the fees to be allocated to regulatory functions are sufficient to effectively discharge those functions; and*
> *e. the approved regulator has addressed any significant areas of concern raised by the Board in the previous year's application, or if it has not, provided a reasonable explanation as to why not.*

Further detail must be set out in the Rules on the procedures that the LSB intends to apply in determining applications (e.g. timescale for decisions, process for extending that timescale, etc.) and about the criteria it will use to assess the information that has been provided. It is essential that regulators understand the criteria that the LSB intends to use so that they can judge their own approach to providing the information required. For example: what criteria will the LSB apply to determine whether an increase in fees is "reasonable and proportionate" and whether the fees allocated to regulatory functions are "sufficient"? What criteria will the LSB use to assess progress against recommendations made in its previous PCF decision? What criteria will be used to assess progress in the regulatory performance framework and how will that influence the LSB's decision on that regulator's PCF application? The fact that the LSB has not included any criteria in the draft rules means that it should reconsult on what those criteria should be.

Comments on proposed guidance

Please note that this section sets out our main areas of concern with the proposals. The LSB should not assume that if we have not commented on a particular rule or section of guidance that we are content with it - our concerns run throughout the proposals.

Section C – Legal Framework

In order to achieve a more targeted and proportionate approach, we urge the LSB to consider whether all the rules (and therefore guidance) have to apply to all the regulators. IPReg collects its own fees and none of those fees are given to CIPA or CITMA. All the activities that IPReg carries out are included in the permitted purposes as defined in section 51(4)(a) and (b) of the Act (rather than those which are more likely to be conducted by representative bodies e.g. law reform, activities on human rights, etc.). The requirements in the rules and guidance for very detailed information about the allocation of activities to permitted purposes (e.g. paragraphs 22 and 35) therefore appear disproportionate for IPReg since there is no possibility for the fees to be used for activities other than permitted purposes.

Section D – Procedure

The LSB should include in the Rules more details about the process it will follow when considering applications (this is a specific requirement in the Act). For example, the timescale within which it will determine applications and the process for extending that timescale. Currently the guidance (but not the Rules) states that it will try to make decisions within 28 calendar days. This is a week longer than the LSB's current target and an explanation should be provided as to why more time is required.

Section E – Overarching Criteria

This section sets out the LSB's "overarching expectations" about the process that the regulator should follow and the information to be provided to the LSB (it does not include any criteria that the LSB will use to assess an application).

This section is an example of where we consider that the LSB has unreasonably extended its scrutiny of regulators' activities. The proposed guidance sets out in such detail what information is required and the way in which it must be provided that the process has become disproportionate, particularly for a regulator like IPReg whose total income each year is only around £1m. We set out some examples below.

- Rule 13(a) Transparency

Paragraph 35 states:

'Programme of activity' is defined in Rule 1 as the activities which will be funded, in whole or in part, by the practising fee. In order to comply with Rule 13(a) on transparency the approved regulator must make clear <u>what</u> these activities are, <u>how</u> the funds will be applied to each activity and <u>why</u> this will benefit the regulated community and/or consumers, with reference to the permitted purposes and the regulatory objectives.

We can see that there may perhaps be benefit in scrutinising in detail the use of fees for, say, the promotion of relations between an Approved Regulator and other national or international bodies (a permitted purpose in section 51(4)(f) of the Act). But it seems disproportionate to require this level of detail for day to day, core regulatory activities such as those that IPReg undertakes; we note that the only 'concession' that the LSB makes (in paragraph 36) where detailed scrutiny may not be required is for the process of setting the PCF and applying for approval of it. We are very concerned that the LSB does not think that what it considers to be "standalone projects" like diversity initiatives, education projects and modernisation or innovation projects are included in regulators' "core legal obligations" (see paragraph 37 of the proposed guidance). For these activities, the LSB states that:

"The approved regulator will be expected to set out how it will measure the benefits of these activities. This should include how the approved regulator has assessed the anticipated benefits at the point that the programme of activity was determined and how it will assess the actual benefits after the activity has been completed."

Given that we all have a statutory duty to improve diversity (and the LSB is pressing regulators to increase their activities on diversity) and that encouraging innovation is a key focus of government and the CMA, we would ask the LSB to reconsider its approach.

- Rule 13(b) – Accountability

We are concerned that the LSB has not been clear about how the outcome of the regulatory performance assessments will influence decisions on PCF applications. Paragraph 41 of the guidance states:

"If the LSB has raised concerns about the previous practising fee application, or as part of the regulatory performance assessments, the approved regulator will be expected to address these in the application."

The implication of this seems to be that if a regulator has not undertaken the steps it needs to under the performance framework, its PCF application may be refused. The LSB should set out what its criteria are for assessing the impact of progress against the performance framework on the PCF application.

- Rule 13(c) – Proportionality

In our view, the allocation of funding to a regulator's activities is a decision for its Board to take, having consulted on its business plan. The LSB appears to be encroaching into this area – it had proposed to do this originally as part of the performance framework but accepted that this was not an appropriate use of its powers. In any event (a) the allocation of costs is likely to change over the course of a year and (b) in a small regulator where most staff work across a range of activities, such a precise breakdown of costs against each activity is simply not possible.

- Rule 13(d) – Consistency

This states:

"Each approved regulator should set out its strategic objectives and priorities for the practising fee year. The practising fee should be allocated within the programme of activity consistently with those objectives and priorities."

As above, this seems to be encroaching into the role of the regulatory Board. If the LSB requires this information, it must have criteria for assessing it and should set out what they are in order to provide transparency about what it considers its role is in these matters.

Section F – Allocation of Practising Fee to Permitted purposes

Please see our comments above. It seems that the LSB has identified an issue (which does not seem to have been articulated in the consultation) with the allocation of the PCF in bodies where it is divided between the representative body and the regulatory body. That does not apply to IPReg and we therefore suggest that in order to be proportionate and targeted, this section should be disapplied if the regulatory body collects its own fees and does not pass any of them to the Approved Regulator.

An example of where the requirement is disproportionate is for Rule 15 where the guidance states:

"*Rule 15 requires each approved regulator to set out the programme of activity for the practising fee year. This should be done in the table set out in the pro-forma application at Annex A of this Guidance. In forming the programme of activity, each approved regulator must identify which permitted purpose or purposes that activity is for and this should be stated next to each activity. The LSB would expect the approved regulator to state the figure allocated to the activity, also expressed as a percentage of the overall practising fee income. If the activity is to be funded by any other source of income, this should also be stated.*"

The guidance also states (paragraph 60) that the application must also set out:

"*the set of objectives and priorities which have led to the allocation of funding*."

In our view, these are examples of an unnecessary level of detail for a regulator whose funding is entirely separate from that of the Approved Regulator. It is also symptomatic of an increasingly micro-management approach to consideration by the LSB of fee levels.

Section G – Financial Information

The LSB has not explained why it considers the provision of 3 years' forecasts is necessary or useful since it is likely that these forecasts will change as regulators adapt to various events and embark on new projects. If 3-year forecasts are required, we suggest that the LSB should allow fees to be set for up to 3 years (with the provision to change them after consultation if required). This would enable more certainty for the regulated community and would significantly reduce the burden and cost of having to apply to the LSB every year.

It is not clear why the LSB regards variance of more than 2% between actual and budgeted income as "significant" (paragraph 68); the figure seems exceptionally low and we suggest that 10% would be a more proportionate number. It is also not clear what criteria the LSB will apply to assess any variances (whether 2% or higher). In any event, we consider that any variance in actual vs budgeted income is a matter that regulatory Boards should deal with, not the LSB.

Section H - Reserves

This is another area where we consider that the LSB is encroaching on decisions that regulatory Boards are responsible for. It also seems that the level of detail required is specifically aimed at those bodies where the LSB considers that there has not been clarity in the past about who holds reserves that arise from practising fees and what they are subsequently used for. IPReg has published its reserves policy and publishes the level of its reserves each year. This has always been sufficient in the past and the LSB has not set out what issue it has identified for IPReg that would now require us to change our approach to the way we allocate and spend our reserves.

In suggesting that it might require any surpluses over the target level to be used to lower fees, the LSB has not taken into account the fact that this is likely to result in significant fluctuations in fee levels year-on-year which increases uncertainty for the regulated community and makes it harder for them to budget for. IPReg has seen exactly this issue with fluctuations in the LSB's levy as a result of underspending its projected budget, leading to increased levies in subsequent years when there is less of an underspend.

Section J – Impact Assessments

We are concerned that the LSB has not made any attempt to set out what information it expects EIAs and RIAs to include and what criteria it will use to assess them. Most impact assessments published by government departments are extremely detailed and take a considerable amount of time and expertise from economists and statisticians to compile. If something less onerous is required by the LSB, then it must set out what this looks like in practice. We note that the LSB's own RIA at paragraph 101 of the consultation document does not contain any evidence about how "the costs associated with compliance with the new draft Rules are outweighed by the anticipated benefits". There are various assertions about the hoped-for benefits of the changes, but no evidence about the increased cost to regulators including the LSB (and therefore to those who pay the fees) of operating the new system.

We note that under the relevant equalities legislation there is no specific duty to conduct an EIA and that the EHRC has not produced guidance on EIAs. It is not, therefore, clear why the LSB is imposing this

requirement on the legal regulators (see paragraph 99 of the consultation document). We consider that it would be appropriate for the LSB to suggest that regulators should follow EHRC guidance (e.g. on meeting the equality duty and making fair financial decisions) but not to go further than that.

Conclusion

The LSB is proposing to increase significantly the burden of regulation on legal regulators. It has not adopted a proportionate or targeted approach and its proposals do not adhere to best practice in terms of adopting a principles-based approach to regulation. It is proposing to fetter significantly the way in which regulatory Boards can exercise their discretion and judgement to allocate funds to different activities and what those activities can be. We urge the LSB to re-think its approach.

Yours sincerely

Fran Gillon
Chief Executive