ICAEW
REPRESENTATION 84/20

LSB PROPOSED PRACTISING FEE RULES

A CONSULTATION ON NEW DRAFT RULES TO REPLACE THE PRACTISING FEE RULES 2016 MADE UNDER SECTION 51 OF THE LEGAL SERVICES ACT 2007

Issued 9 October 2020

ICAEW welcomes the opportunity to comment on the consultation document *PROPOSED PRACTISING FEE RULES* published by the Legal Services Board in August 2020, a copy of which is available from this link.

Our response is solely in respect of our role as an Approved Regulator under The Legal Services Act 2007, supervising approximately 340 firms.

ICAEW is a world-leading professional body established under a Royal Charter to serve the public interest. In pursuit of its vision of a world of strong economies, ICAEW works with governments, regulators and businesses and it leads, connects, supports and regulates more than 154,000 chartered accountant members in over 160 countries.

This response dated 9 October 2020 reflects the views of ICAEW as an Approved Regulator for the reserved legal service of probate. ICAEW Professional Standards is the regulatory arm of ICAEW. Over the past 25 years, ICAEW has undertaken responsibilities as a regulator under statute in the areas of audit, insolvency, investment business and most recently Legal Services. In discharging its regulatory duties it is subject to oversight by the Conduct Committee of the Financial Reporting Council (FRC), the Irish Auditing and Accounting Supervisory Authority (IAASA), the Insolvency Service, the Financial Conduct Authority (FCA), the Legal Services Board (LSB) and the Office for Professional Body Anti-Money Laundering (OPBAS).

Amongst ICAEW's regulatory responsibilities it is;

- the largest Recognised Supervisory Body (RSB) and Recognised Qualifying Body (RQB) for statutory audit in the UK, registering over 2,600 firms and 7,000 responsible individuals under the Companies Act 2006.
- a Prescribed Accountancy Body (PAB) and Recognised Accountancy Body (RAB) for statutory audit in Ireland, registering approximately 40 firms and 250 responsible individuals under the Republic of Ireland's Companies Act 2014.
- the largest RSB for local audit in England. It has eight firms and over 90 key audit partners registered under the Local Audit and Accountability Act 2014.
- the largest single insolvency regulator in the UK licensing some 800 of the UK's 1,600 insolvency practitioners as a Recognised Professional Body (RPB) under the Insolvency Act 1986.
- a Designated Professional Body (DPB) under the Financial Services and Markets Act 2000, currently licensing approximately 2,000 firms to undertake exempt regulated activities under that Act.
- a Supervisory Body recognised by HM Treasury for the purposes of the Money Laundering Regulations 2007, dealing with approximately 11,000 member firms.
- designated an Approved Regulator and Licensing Authority for probate under the Legal Services Act 2007 (the Act) currently accrediting approximately 300 firms to undertake this reserved legal activity.

OPENING REMARKS

General

1. While we recognise that section 51 of the Legal Services Act 2007 (the Act) requires the Legal Services Board (LSB) to make rules specifying the permitted purposes for the 'practising fee' and about the form and manner in which fee approval applications must be made (the Rules), such Rules should be framed so that they are applicable and proportionate to the whole range of legal services regulators, whose size and structures are markedly different.
2. What is the purpose of the PCF approval process? If it is in place to prevent regulators from deciding to increase their fees by an unreasonable and disproportionate amount beyond the funds they need to discharge their regulatory functions in order to stop such fees being passed through by firms to consumers, then the new Internal Governance Rules (IGRs) have created an effective check and balance on this by any such increases now having to be approved by an independent regulatory board with a lay member majority. Such a board is not going to approve big increases without good reason. It should and can therefore perform the gatekeeper function for this instead of the LSB.
3. A further effective check and balance against unreasonable fee rises is market forces. No regulator has a monopoly and firms can choose to seek their accreditation or licence from another regulator if it is considered fees have become too high.
4. If, conversely, the process is in place, and is intended to be kept in place, to stop regulators making no fee increases or even reducing fees which might be thought to jeopardise their ability to discharge all of their regulatory functions, then again the new IGRs have created an effective check and balance for this as the lay member majority independent regulatory board will be in a position to question why no increases are required where, for example, wage inflation for staff will mean costs will rise.
5. The regulatory boards in place for bodies which regulate a number of services will also be best placed to see whether a 0% increase is consistent with changes in fees being proposed for other regulatory services. While we believe, again, this diminishes the need for a continuation of the LSB's current process around the PCF application, the LSB could perhaps instead feed into the decision-making process of the regulatory boards in advance of their decisions on setting the regulatory budget by ensuring that their performance evaluation assessments are timed to be provided to the regulatory board to be taken into account when fees are set? This would be particularly useful if there were good reasons for concern on the part of the LSB executives that the regulatory body was exhibiting classic signs of insufficient funding by being unable to respond fully and timeously to reasonable demands being placed on it by failing to attend important meetings concerning legal services regulation or by failing to execute any part of the prior year strategy without good reason.
6. The proactive feeding in, rather than checking after, would be a much more useful role for the LSB to play and would put the necessary respect and assurance into the new independent regulatory boards, boards which the LSB has spent several years trying to put in place and which are now stocked by some very impressive individuals who will challenge and seek justification just as diligently and robustly as the LSB has done in the past.

Conflict / duplication with the outcomes of the IGRs

7. At the urging of the LSB, all regulators, including ourselves, have made considerable efforts to make changes in the governance around our regulatory functions. It was our expectation and understanding, from reading the guidance to the IGRs, that improvements such as:
    a. The lay majority and lay chair requirements in the regulatory board
    b. Independent appointment committees for the regulatory board
    c. No dual roles
    d. The regulatory board having autonomy over the setting of the regulatory budget

e. The regulatory board having a duty to ensure sufficient resources

were designed to provide the LSB generally with greater assurance about the robustness and quality of decision-making of regulators, and to provide the LSB specifically with assurance regarding the judgements being made in respect of the setting of regulatory fees as part of the budgeting process

8. However, it would appear from a review of the proposed Rules that, not only is there an intention on the part of the LSB to continue to enquire about the rationale for decisions taken in respect of fees, but that such enquiries and information requests will broaden. We do not understand why there is a need for such duplication of the work being done on this by the independent regulatory boards put in place by all regulators. Similarly, why the LSB, now that it has assured itself as to the independence of the budgetary processes, needs to do anything more than make a few appropriate enquiries to ensure that all of the right matters were considered by the regulatory board in reaching its conclusion on fees.

Reliance by other regulators on judgements of ICAEW Regulatory Board ("IRB")

9. While we have provided all of the information which has been requested every year in respect of our PCF application, we have been surprised at the request for such extensive information to be provided by Professional Standards staff, and at the extensive subsequent enquiries which are made in relation to the information provided. It has always been unclear to us why so much information has been requested given that decisions on regulatory fees have been taken by our independent regulatory board, the IRB. It is also unclear what regulatory model the requests for information is based on and what research was carried out by the LSB executives prior to drafting the Rules into the standard practices and requirements of other longstanding oversight regulators in relation to assurance around the setting of fees.

10. The information requests from the LSB (based on a comparison of what has been, and will be (under the new Rules), required by the LSB executives) are significantly out of kilter with the requirements of our other oversight regulators. As the LSB is aware, our main oversight regulators are the FRC (for audit and accountancy) and the Insolvency Service, but that our work is also overseen by IAASA (for Irish audit and accountancy work), the FCA (for investment business advice) and OPBAS (for our AML supervisory work). None of these other oversight regulators request anything approaching the same level of information as the LSB. Indeed, since the establishment of the IRB, none of our oversight regulators have raised any questions about the decisions made by the IRB on changes to audit registration fees, insolvency licence fees, DPB fees and beneficial owner fees (for AML). All of our other oversight regulators have satisfied themselves about the robustness of our governance arrangements and the competence of the IRB (through observing it in action). All are content to rely on the judgement of the IRB in setting fees for their regulated areas, which is sufficient to discharge all of our regulatory responsibilities.

11. In the case of the FRC, we regulate the audit work of over 2,600 accountancy firms and are the largest RSB in the UK, with audit registration fee income in excess of £7m. Our responsibilities are extensive and are set out in detailed Delegation Agreements which require each RSB to raise sufficient money to fund its required activities. We do not have to submit an application to the FRC (or any of our other oversight regulators) for approval of proposed fee increases and we are not asked for justification of any annual changes in audit registration fees. The FRC relies on the IRB to make the right judgements on these matters and concentrates its focus instead on the annual inspection it carries out of our audit regulatory work to assure itself that we are in compliance with the obligations in the Delegation Agreement.

12. Even if the LSB had doubts about the independence or robustness of the IRB prior to the recent changes we have made to ensure compliance with the new IGRs, we do not understand why the LSB now feels it necessary to continue with the same micro-management of the fee setting process as it has done in the past, in contrast to all of our other oversight regulators.

13. In the context of one size fits all, we are concerned that the dynamics of the Law Society and the SRA are having a dysfunctional impact on other regulatory bodies such as ICAEW where the practising certificate fee has a different role in the professional body and a different importance in revenue stream. In the case of the Law Society the practising certificate fee needs scrutiny because there is apportionment between the regulatory and professional bodies, and the act requires supervision of both the authorised body and regulatory body in this context. A closer examination of the expenditure of both bodies is accordingly warranted. However, in the case of ICAEW the practising fee is firstly an accountancy fee, not a legal fee and secondly none of the income from it is used for regulatory purposes. The regulatory body has a completely self-funding financial structure under the control of the IRB.
14. Although the LSB accept the ICAEW practising certificate fee itself is not within the scope of section 51 enquiries, the same level of detail is still applied to the self-funding unit and its probate licensing fees. This is disproportionate when the outcome sought by section 51 – proper balanced financial independence – is already being achieved by the financial structure and its supervision under the IGRs.

Proportionality

15. The Rules do not appear to reflect the wide spectrum of legal services regulators overseen by the LSB, the number of firms they regulate, their practice fee / licence income, the number of reserved services they regulate or the size of their executive,
16. We would, therefore, suggest that the new Rules be amended to give due regard to:
    a. Compliance with the IGRs
    b. Proportionality
    c. Consistency*
    d. What is reasonably practicable (s28) and of value
    e. Greater reliance on what in the view of the regulatory body is most appropriate
    f. Recognition of market forces, and
    g. A more focussed application approval process.

    *not amending and expanding the process every two years
17. We believe that a proportional approach can be achieved by:
    - Relying on the judgements taken by the independent regulatory boards with enquiries only being made where decisions are taken outside a reasonable range of responses
    - Regular communications and feedback already submitted throughout the year on key aspects of a regulator's duties;
    - Observation of regulatory board meetings to obtain assurance as to the robustness of its challenge to executives and the competence of its decision-making
    - The LSB requesting updates only when something has changed rather than requiring regulators to send in the same nature of information every year;
    - A much reduced information requirement if a regulator is not seeking to increase its fees;
    - Leveraging discussions at the various LSB / regulator and CEO forums which reviews and discusses many of the items included in the PCF application process,
    - LSB executives referencing published materials which have been made available online, and
    - Ensuring that strategic and operational planning, and progress reviews, are complete in advance of annual budgets and fee setting.
18. This information-sharing and a collaborative approach between the LSB and those it regulates would allow for a proportional approach and would put the LSB in line with the approach taken by other oversight regulators. It would reduce significantly the current

duplication of effort and the requirement by regulators to re-submit or cut-and-paste materials into the fee application template.

19. For regulators with a differing model, Rule 31 (b) to (e) simplifies the PCF application to the core section 51 components and this illustrates an opportunity for streamlining the process to focus only on these areas.

20. In contrast, a disproportionate and duplicative approach to the PCF application will damage consumer interests. We believe this to be the case because, after our experience again this year, we may need to consider increasing our probate licence fees next year even if we believe we can discharge our regulatory functions for the following year without any increase. This would be because we will need to start covering the increasing amount of executive time involved in compiling, drafting and submitting PCF applications and then responding to the significant and wide-ranging enquiries. Any increase in the probate licence fees will undoubtedly be passed straight on by firms to their clients. This cannot be a positive outcome for the regulated community or consumer.

21. If our regulated firms considered the fees set by the IRB to be too high after a particular increase, or if any of our regulated firms became discontent with the approach or service provided by us, they have the option to seek regulation from any of the other legal service regulators. Such competition is understandably encouraged by the Act.

22. Therefore, fees are not mandatory as such; those regulated by ICAEW have sought a probate licence within an environment of choice, where competition and access to justice is encouraged. This would differ greatly if, for example, there were a monopoly situation.

Possible new (non-statutory) objective?

23. The focus on the approval of fees appears to have now been extended to an objective which is outside of section 51; *"To support more meaningful discussion and debate across the sector on the purpose, benefits, costs and value of regulation, which ought to result in improved standards"*. We do not believe that the fee approval process is the most appropriate route for this strategic discussion. Charges are downstream of strategic and operational agreements. We believe that such a strategic discussion is more suited at a Board / Chief Executive level.

24. We do not believe that the fee approval mechanism could, or should, be used to agree strategy and operational planning. A debate is also an output. The link and steps to a positive outcome, a hoped-for improvement in standards, is not yet clear or explained in the consultation document.

Interim Fee

25. Were the LSB to withhold or delay approval of the fees (even to a proposed reduction in fee or no change to the fee), and not allow an interim fee, this would mean that the regulator could not raise appropriate funding and would be potentially quickly and seriously financially exposed.

26. We would recommend that Rule 14(d) is retained. The situation, in which a submission is rejected and a resubmission required, would hopefully be very rare. However, the absence of an option to charge any fee (even an interim fee, which could for example be the previous year's fee) creates a risk of leaving the regulator without operational funding.

27. There is a suggestion that, if funding were not available due to fee application delays:

    - The regulator should then draw on reserves

      This is not possible as the regulator is required to maintain reserves at a specific level. The rejection of a fee application does not mean that the reserves Rule is then suspended.

    - The regulator draw-down on uncommitted reserves

'Uncommitted' is not a term that we recognise. Assuming there are such reserves, above and beyond requirement (although the source of such reserves is unclear), they should be being returned by reducing fees charged in the following year so are not available to be utilised.

The outcomes

28. These all appear to be outputs of a process and are, therefore, not obviously linked to – positive outcomes - improvements for the consumer of legal services.
29. *'A key aim is to increase transparency about the Approved Regulators' and Regulatory Bodies' programmes'* - it appears that the LSB have added this to the section 51 requirements. We do not consider that this is needed as the programme of activities is already reported separately.
30. *'This should lead to a more meaningful debate on the purpose, benefits, costs and value of regulation, which ought to result in ongoing improvement of standards across the sector'* - this is an admirable goal and worthy of a programme of work. However, as part of the fee approval process, such outputs are highly speculative and unlikely to be achieved as the scale of operations of the regulators, corporate set-up, population served and even the way regulators charge fees is materially different.
31. *'The proposals also aim to inform the LSB's oversight responsibilities, including better integration with the LSB's wider performance assessment framework'*- this would appear to imply a duplication of the other activities throughout the year. Indeed, the existing oversight and performance assessments should provide the LSB with this information and should act, like the FRC inspections, as a cross-check to ensure that the regulatory fees set by the regulatory board are providing sufficient resources for the timely and effective discharge of regulatory obligations.

Question 1: Do you have any comments on the above draft Rules 1 to 12? Do you have any comments on the associated draft Guidance?

33. We believe the new Rules should have been drawn up to reflect the greater ability of the LSB to rely on the fruits of the implementation of the new IGRs and to reduce the requirements on the regulators to provide information to justify the fee increase being proposed. We do not understand the need for the continuation of what is already in place, or an expansion of that process. Such expansion will only lead to considerable duplication between the efforts of members of the new regulatory boards to determine the most appropriate fee levels for the following year and the review by LSB executives. The empowering of the independent regulatory boards and insisting they have autonomy over regulatory budgets should obviate the need for their decisions to continue to be the subject of in-depth analysis and study by LSB executives.
34. We would urge the LSB to leverage the oversight functions it has improved and to simplify both the Rules and the PCF application template.

Question 2: Does the overarching criteria in draft Rule 13 adequately set out the LSB's expectations of Approved Regulators when considering a practising fee application? Are there other criteria which should be included? Do you have any comments on the associated draft Guidance?

35. While Rule 13 sets out the expectation, we consider this to be over-complex and disproportionate for the differing models of regulators. We also believe that it does not take account of the fruits of the improvements to governance at the regulators achieved by the new IGRs, and that it further complicates the PCF template and application process.
36. We would note that section 51 requires only confirmations that funds are used for permitted purposes, that reserves are adequate and not excessive, and that the regulator has consulted on the approach and impact to fee setting and any change. It appears to us that the LSB is creating a complex, and subjective, process which risks being open to inefficiencies and inconsistencies.. We believe that this may quickly become a regulatory cost burden for all involved, as evidenced by the complexities seen in 2021 applications.

Question 3: Do you have any comments on draft Rules F 14 to 16? Do you have any comments on the associated draft Guidance?

37. In the case of ICAEW the practising fee is firstly an accountancy fee, not a legal fee and secondly none of the income from it is used for regulatory purposes.
38. The regulatory body has a completely self-funding financial structure under the control of the IRB.
39. We believe that these Rules should focus on proportionality, what basic information is required and what reliance can be placed on the judgements made by the independent regulatory boards.

Question 4: Are draft rules H19 to 23 clear? Do you have other comments on these draft Rules or comments on the associated draft Guidance

40. We do not believe that these Rules are clear on how they will be applied to regulators with differing models. We also note that some of the general terms are not defined.

41. It would be helpful if the Rules could be clearer on proportionality, what basic confirmation is required and what reliance is placed on judgements made by the independent regulatory boards.

42. We would note that section 51 already requires that a regulator should have adequate reserves, including the equivalent of 3-6 months of operating cost.

43. Rule 19 does not appear to recognise the practicalities and synergies in accounting and banking. It also appears to suggest that, if the reserve is not held in a separate account, then it cannot exist at all. This is at odds with the requirement to hold a reserve which must be the priority.

44. It is not clear what is meant by *"uncommitted reserve"*, and *"Adverse circumstances"* is also not defined. We would note on the latter that there are few who could have predicted Covid-19 and its financial impact. We believe that it would be inappropriate to expect the regulator to provide reserves for any adverse circumstance.

45. We note that there are a number of general or ill-defined expressions in the Rules and guidance, which risks too much subjectivity seeping into the process and inconsistent application and outcomes.

46. A simplified process, more aligned to the core section 51 requirements, coupled with greater reliance on the judgements of the independent regulatory boards, would be a preferred approach.

Question 5: Do you have any comments on draft Rules I 24 and 25? Do you have any comments on the associated draft Guidance?

47. The proposed extension of the requirements of the fee consultation does not appear to recognise the ongoing engagement with the regulated community and other key indicators. Consultations in the context of a 0% increase are unnecessary.

48. We would note that fees charged serve to fund registration, quality assurance, policy and disciplinary functions. Our regulated community will be well aware of the components which make up a regulator's activities, which are not unique to legal services regulation, and the need for funds to be allocated to these activities. It is unclear what will be achieved by a compulsory consultation each year with the regulated community to explain to them what they already know other than to drive up the costs of regulation which will be passed onto them and, ultimately, the consumer.

49. Similarly, the structure of charges is published each year in a standard form. If this were to change, a consultation would be justified. However, a justification for a compulsory consultation with the regulated community in years where the structure is not changing is unclear.

50. The LSB has requested that Approved Regulators commit to certain longer-term activities, such as the funding of Legal Choices. It is unclear how the new requirements to consult reflect this commitment to an activity in advance. Is the regulator required to consult with its community on each activity in retrospect or in advance?

51. The lack of response to a consultation should not be used as a measure for the level of endeavours or engagement.

52. Rule 25 does not define key terms and therefore risks introducing subjective and unevidenced judgements to a process. In addition, it does not describe how proportionality will also be applied.

53. Response rates to consultations can be low for many reasons. It might be said that it reflects trust in the regulator. It would be helpful if you could share your evidence that most regulators have failed to engage adequately with their regulated community.

Question 6: Are Rules J 26 to 30 regarding initial and full impact assessments clear? Do you have any comments on the associated draft Guidance?

54. The Rules are not clear.

55. If the regulator has conducted an impact assessment, even though as stated such an assessment it is not mandatory, what is the meaning of 'initial'?

56. It seems to be inappropriate for the draft Rules to 'require' the regulator to conduct assessments and sub-assessments and follow-up assessments when the assessments are not mandatory. Again, this is a matter for the independent regulatory board to consider.

57. If the assessments are not mandatory, it would perhaps be more beneficial if the LSB can describe what would be a proportional and best practice assessment.

Question 7: Does the criterion set out at draft Rule K 31 adequately explain the matters which the LSB requires to be satisfied to approve a practising fee application? Are you content that the Rule for the interim collection of practising fees has been omitted from the draft Rules? Do you have any comments on draft Rules K 32 and 33?

58. These Rules do not appear to reflect or leverage the judgements to be made by the independent regulatory boards put in place by the IGRs.

59. The inclusion of a requirement for the regulator to set out in their application their contingency measures if an application is refused, while removing the option for an interim fee, appear to be at odds with each other.

60. We would suggest that the Rule for the interim collection of practising fees is retained. This is the contingency if an application is refused.

61. Rule 31 (b) to (e) simplifies the PCF application to the core section 51 components and therefore illustrates an opportunity for streamlining the process to focus only on these areas.

62. The Rules do not include how the LSB will assist the regulator as part of the process, on behalf of the registered community and consumers, to achieve the criteria or to resolve issues.

63. The Rules do not include any reference or guidance where the fees do not change, and the associated proportionality to be applied to the process in such a situation. Our view is that in such circumstances, subject to our Board's approval, an application to the LSB should be unnecessary.