

Legal Services Bill

Supplement to Regulatory Impact Assessment

Introduction

1. The Regulatory Impact Assessment (RIA), which was published with the Legal Services Bill in November 2006, set out the rationale for the reform of regulation of legal services. In March 2006, the Department for Constitutional Affairs (DCA) engaged PricewaterhouseCoopers (PwC) to prepare an independent report in connection with the DCA's consideration of the financial assessment of legal services reform. This report was published in May 2006. PwC's report, using broad assumptions, provided estimates for implementation and running costs of the options considered for regulatory reform, as well as reform of the complaints handling system. These estimates were used in the RIA to inform the Government's evaluation of the different policy options for reform.
2. Things have moved on considerably since PwC produced their report. Our implementation plans have been refined and amendments have been made to the Bill.
3. During the Lords debate on the Legal Services Bill at Report stage, on 8th May 2007 peers were supplied with revised headline figures for the costs associated with legal services reform. This supplement to the RIA, which was published with the Legal Services Bill in November 2006, seeks to provide further information on the costs stated during the debate.
4. PricewaterhouseCooper's (PwC) original forecast (in 2005 prices) for implementation costs was £26.8 million, of which £13.6 million would be recovered through the levy, £10.9 million would fall directly on the Law Society and £2.3 million would fall on the DCA now Ministry of Justice (MoJ). Following further analysis by officials, the forecast for implementation costs now stands at **£32.1 million** (in 2007-08 current prices) of which £19.9 million would be recovered through the levy, £9.8 million would fall directly on the Law Society and £2.4 million would fall to the MoJ.
5. Running costs have also been reviewed and at 2007-08 current prices they now stand at £4.0 million for the Legal Services Board (LSB) and £19.9 million for the Office of Legal Complaints (OLC). PwC established running costs (in 2005 prices) stood at £3.6 million for the Board and £16.8 million for the OLC.
6. The tables in Annex A which provide a more detailed breakdown of figures for the revised implementation and running costs also show PwC figures at 2007-08 prices for comparison purposes.

Scope

7. As stated in the full RIA published with the Legal Services Bill, its purpose was to set out the rationale for the reform of the regulation of legal services and analyse the likely effect on a range of key stakeholders of the options considered for

implementing these reforms. It is not the intention of this supplement to revisit this work but only to provide a cost update based on the most current information available, with regard to the implementation of the preferred options identified in the RIA.

8. The preferred option for reforming the regulatory framework for legal services was to create a new independent oversight regulator, the Legal Services Board (LSB). In relation to reforming the complaints handling arrangements in legal services the preferred option was a new single complaint handling body, the Office for Legal Complaints (OLC), which would be independent from Approved Regulators.

Reforming the Regulatory Framework for Legal Services

9. As detailed in part 4 of the RIA 'Reforming the Regulatory Framework for Legal Services' the preferred option was the establishment of a Legal Services Board, as an oversight regulator.
10. PwC's original forecast for implementation costs for the establishment of the LSB was £2.3 million (in 2005 prices). Following further analysis by officials, the forecast for implementation costs now stands at £4.2 million. The ongoing running costs as established by PwC were £3.6 million (in 2005 prices) of which £1.9 million were direct staff costs. The revised running costs of the LSB are now £4.0 million of which £2.0 million are direct staff costs.
11. These calculations are still based on the base case assumptions as established by PwC of 39 core staff members, with a 9-member board, a 10-person Consumer Panel in an out-of-London location and the assumption that the underlying nature of the regulatory activities, within the remit of the LSB's framework, would not be substantially different from those performed under the current regulatory framework.
12. Main adjustments to the implementation and running costs of the LSB include:
 - All costs now stated at 2007-08 current prices
 - VAT has been included in implementation costs
 - Provision for staff training prior to go-live of the LSB
 - Provision for a rules formation team, which will be responsible for developing different rules and policy statements for the Board.
 - Provision for a project team to support the Board once they assume responsibility for managing the implementation process

Reforming the Complaint Handling Arrangements in Legal Services

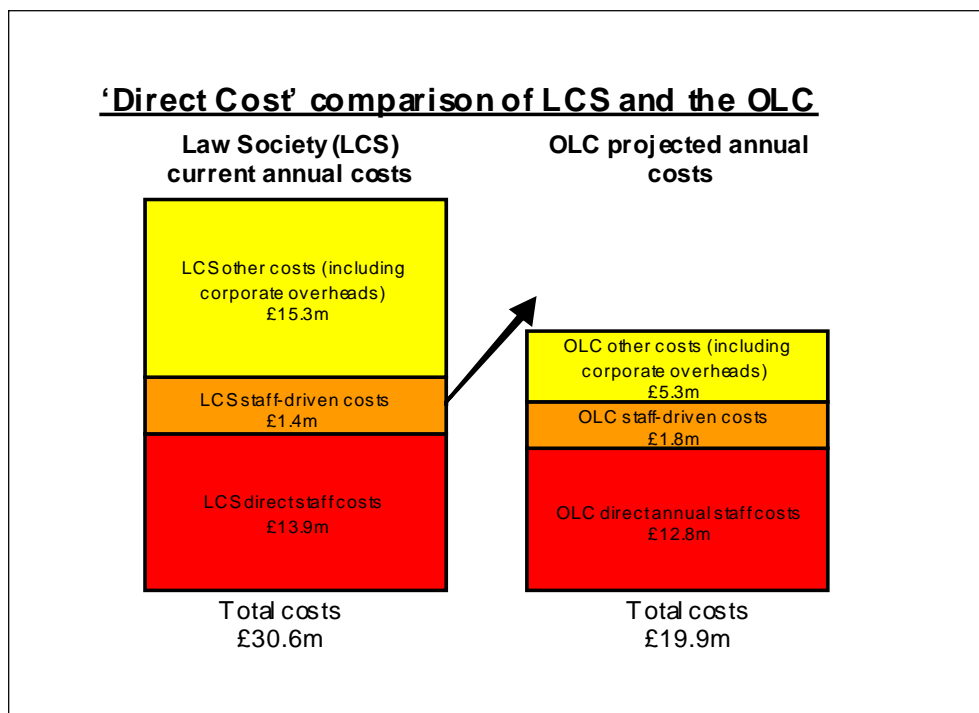
13. As detailed in part 6 of the RIA 'Reforming the Complaint Handling Arrangements in Legal Services' the preferred option was the establishment of a single complaints handling bodies for the entire profession, that is the Office for Legal Complaints.
14. PwC's original forecast for implementation costs for the establishment of the OLC was £23.6 million (in 2005 prices). Following further analysis by officials, the forecast for implementation costs now stands at £26.7 million in 2007-08 prices.

The ongoing running costs as established by PwC were £16.8 million (in 2005 prices) using their base case scenario. The revised running costs of the OLC are now £19.9 million in 2007-08 prices.

15. These calculations are still based on the detailed work that PwC did in relation to organisational design and the assumptions of a 7-member board and offices based in the West Midlands. However the staff profile has been adjusted to reflect an assumed year-on-year 5% increase in case receipts between now and go-live of the OLC. This has led to an increase in staff from the 319 as estimated by PwC to 355 (excluding the board).
16. The same adjustments as listed above at point 12 in relation to adjustments made to LSB costs were also applied to the OLC.

Efficiencies based on cost revision

17. The RIA in section 6 discusses the issue of efficiency gains made by the OLC over the current complaint handling system. With the annual running cost of the OLC now estimated at £19.9 million (at 2007-08 current prices), there is now an estimated efficiency saving of 35% between the costs of the LCS and OLC, rather than the original PwC estimate of 40%. However, the OLC costs are now based on additional work undertaken to profile case receipts and therefore it is estimated that the OLC will be dealing with a higher volume of cases than originally estimated, with a year-on-year increase of 5%.
18. The figure below, which was contained in the original RIA (p.48), has been updated and now compares the cost breakdown of the revised estimate against the annual outturn figures provided by the LCS for the period ending December 2006.



19. Factors identified by PwC which contributed to the estimated saving, and which are still relevant in relation to the revised costs, included:

- A “bottom-up” approach to the calculation, based on a completely new cost model
- Reduction in the overhead costs for the OLC as compared to those levied on the LCS by the Law Society under current arrangements
- No contribution required to the cost of the Office of the Legal Services Ombudsman
- Implementation of modern systems and processes
- 15% efficiency gain in relation to case-handling

In reaching their assumption, PwC were further influenced by research conducted by Experian in January 2004 for the Lyons Review into the effect that public sector relocation can have on embracing different working methods and technologies.¹

Funding of Implementation Costs and the Effect on Professions

20. As stated in the RIA the Legal Services Bill includes provision for the LSB to make a levy on the profession to fund the cost of establishing and running the new arrangements. In part 12 of the RIA ‘Implementation, Delivery Plan and Post-Implementation’ paragraphs 12.6 to 12.9, information was supplied in relation to the affordability of this to the professions, which has been updated below.

21. The legal services industry was estimated by the Office of National Statistics² to have a provisional turnover of £22 billion in 2005. Figures for members subject to regulation by the eight front line regulators identified by the bill in May 2005 stands at some 148,000. So at the most basic level, we could conclude that each regulated person is now responsible for generating a turnover of around £132,000 a year.

22. It would be for the LSB to apportion costs on a fair and proportionate basis between approved regulators. And in turn it would be for approved regulators to pass on these costs, again on a fair and proportionate basis, to those they regulate.

23. Although the basis for apportionment of implementation costs is yet to be agreed, at the most basic level the £19.9 million estimated as being recoverable through the levy would represent a contribution of some £45 per year per member of an approved regulator over the repayment period (assumed here to be three years). This is based on the 2007 membership figures supplied by regulators; and on the assumption that the LSB will seek to recover the costs over a three-year period in order to reduce any possible impact.

¹ For more information see: <http://www.hm-treasury.gov.uk/media/98E/EB/ExperianResearch.pdf#search=%22Experian%3A%20%E2%80%98The%20Impact%20of%20Relocation%E2%80%99%20January%202004%22>

² Office of National Statistics, Annual Business Inquiry – <http://www.statistics.gov.uk/abi>

24. The implementation costs of £9.8 million which would fall directly to the Law Society are made up of two components. £6.2 million relates to the one-off costs of closing down the Legal Complaints Service (LCS) and any period of parallel running which may be required during handover. This equates to approximately £59 per member, based on a membership of approximately 104,500 in May 2007. The remaining £3.6 million which was identified by PwC relates to overhead charges levied by the Law Society onto the LCS, which the Law Society will be unable to avoid at the time the new complaints service goes live. This would constitute an additional one-off charge to Law Society members of £34 per person.

Methodology & Assumptions

25. The work undertaken by PwC to produce the 'Financial Analysis to support the draft Legal Services Bill' published in May 2006 has provided the basis for the further work undertaken by the MoJ to update the costs based on current information and policy developments.
26. The key areas which were addressed during the review and produced outcomes which varied from PwC's were as follows.

Costs in current 2007/08 prices

27. In updating PwC's financial analysis all costs have been stated in current 2007/08 prices. This applies to both the costs identified by PwC and any additional items that have been identified such as the need for staff training (as detailed below).

VAT

28. VAT has been included in implementation costs as well as running costs. VAT in relation to implementation costs accounts for £3.3million. This figure has been calculated on the basis of advice from Her Majesty's Revenue and Customs (HMRC) that it is prudent to assume all non-staff costs will attract VAT of 17.5%.

Staff training

29. Ensuring staff are adequately trained before the Board and the OLC assume their responsibilities will be crucial to ensuring both organisations are properly equipped from the outset and in a position to get off to the best possible start. Consequently, provision for staff training has been built into the implementation costs and accounts for £1.1million.
30. Identifying the costs associated with training, however, is obviously dependent on a number of factors including the skills and experience of existing staff, training lead in times and the resource needs of the legacy organisations and the new organisations in the lead up to, and following, vesting day.

Caseload Profiling (to inform implementation process and staffing)

31. As a starting point a case work model was built, which profiles the case receipts and closures, and resulting work in progress of the Law Society, and once established the OLC, over the next seven years. The model assumes a year-on-year increase of 5% in case receipts, which is based on the Compound Annual Growth Rate (CAGR) of the Law Society's case receipts for 1977-2006. (The model has been built using Law Society case receipts because they account for 96%³ of the total annual volume of cases. Additional flexibility has been built into the model, however, to take account of complaints about other legal service providers.)
32. This model was then flexed to reflect a revised profile on the basis that a proportion of the Law Society's work in progress will transfer to the OLC following vesting day. This revised profile has in turn been used to inform the number of staff that the OLC will need to have in post and trained by vesting day and its resource requirements over the months that follow. It has also been used to inform the number of staff that the Law Society will need to clear the cases that will not transfer to the OLC and consequently the period of parallel running that will be necessary. The assumptions that have been made in relation to staff training take into account whether staff will be transferring from the legacy entities or whether they will be new recruits. Advice from HR experts and specialists involved in managing training programmes for staff performing comparable functions in other organisations have also been used to inform the staff intake and training schedule and the resulting costs profile.
33. There are obviously a number of different ways in which the implementation from the Law Society and the other professional bodies to the OLC could be managed, and the approach, which has been costed only represents one option. The incoming OLC and its senior management team will undoubtedly have views on the way in which the process should be managed and it will also be critically important for the professional and consumer bodies to be involved in planning for this, and other aspects of, the implementation process.

Other adjustments

34. In addition to restating costs at current 2007/08 prices, VAT and staff training a number of other adjustments have also been made, which have involved both increases and decreases. The key increases include:
 - provision for a rules formation team, which will be responsible for developing the different rules and policy statements that the Board and the OLC will need to be in place prior to vesting day; and
 - provision for two project teams to support the Board and the OLC once they assume responsibility for managing the implementation process.

Contingency

³ This figure is taken from the Legal Service Ombudsman's annual report for 2005/06.

35. The revised figures are based on a robust analysis and consequently the implementation costs will form the basis of the implementation budget for the Board and the OLC. However, it is obviously prudent at this early stage in the implementation process and given the scale of the reform programme, to build in a margin for unforeseen costs. The margin, which has been built in, is 15%, which is approximately £5million.

Assumptions

36. All costs have been calculated with regard to various underlying assumptions as detailed below:

- There are no significant changes to the Bill in relation to the activities of the LSB and OLC.
- The Cabinet Office will classify the bodies as NDPBs
- That all expenditure will be incurred by the LSB and OLC (excluding the recruitment costs for the Chair and Board for both organisations and any costs directly incurred by the Law Society or MoJ)
- Pay and benefits will be modelled on MoJ and LCS as appropriate

37. Assumptions which relate directly to the LSB are:

- 38 staff including CEO (excluding Board and Chair)
- The office will be in an out-of-London location
- That the LSB will utilise central services supplied and supported by MoJ

38. Assumptions which relate directly to the OLC are:

- 354 staff including both the CEO and Chief Ombudsman (excluding Chair and Board)
- A 5% increase in complaints year-on-year until go-live of the OLC
- The office will be in a West Midlands location
- 80% of staff will transfer from LCS

Summary and Conclusion

39. Based on PwC's original estimate of the financial impact of the changes to the entire industry, the revised costs would still see a net decrease in overall cost to the legal services sector of £3 million. However, the increase in estimated running costs of the LSB and OLC may also be matched by an increase in the net regulatory cost of the industry since PwC's figures were produced in 2005 prices.

ANNEX A

Legal Services Reform Programme - Implementation Cost

	MoJ	Law Society	LSB/OLC Levy	Total
	£'000	£'000	£'000	£'000
<u>Implementation Cost for LSB</u>				
Salary Costs	2		1,588	1,588
Project Management	3		749	749
Recruitment Costs			500	500
Staff Driven	4		109	109
Accommodation	5		620	620
Business and IT Development	6		115	115
Other Costs	7	75	195	270
Total Cost for LSB Implementation	75	0	3,876	3,951
<u>Implementation Cost for OLC</u>				
Salary	2	1,785	2,033	3,818
Project Management	3		1,169	1,169
Recruitment Costs			568	568
Staff Driven	4		716	716
Accommodation	5		4,880	4,880
Business and IT Development (inc Data Migration)	6		3,000	3,000
Other Costs	7	1,116	1,583	9,531
Total Cost for OLC Implementation	1,116	8,617	13,949	23,682
MoJ Programme Management Costs		1,161		1,161
Total Implementation Costs (Exc. VAT)	2,352	8,617	17,825	28,794
VAT @ 17.5% (non-staff)	8	1,196	2,070	3,266
Total Implementation Costs (Inc. VAT)	2,352	9,813	19,895	32,060
PwC Implementation Costs (at 2007-08 Prices)	9			28,198

Notes

- 1 All costs are stated at current 2007-08 prices
- 2 Salary costs relate to senior management in place during implementation (e.g. Chair, Board, Chief Exec.)
Also includes staff for rules formation and staff training and restructuring costs for the LCS

- 3 Staff which will support each Board during implementation and associated accommodation costs
- 4 Costs which directly relate to staff e.g. Travel and Subsistence and Pension set up.
- 5 Includes all costs associated with finding accommodation and the fit out
- 6 Includes Business Analysis, Organisational/Process Design, Development of IT, specialist IT Project Management
- 7 Includes Communications, premises exit cost for existing organisations, running costs of LSB and OLC prior to go-live due to staff training, and any parallel running costs associated with the OLSO and LCS Holborn site following go-live of the OLC.
- 8 A 17.5% VAT provision on all non-staff costs per HMRC guidance, excluding early recruitment costs incurred by MoJ
- 9 PwC figures have been inflated using the CPI to provide comparative figures.

Legal Services Reform Programme - Base Case Running Costs
2007-08 Prices

		Total £'000
<u>Running Costs for LSB</u>		
Direct Staff Costs	1	1,983
Staff Driven	2	112
Accommodation	3	467
Other Costs	4	1,100
Irrecoverable VAT	5	294
Total Reviewed Cost for LSB Running Costs		3,956
PwC Established Running Cost (at 2007-08 Prices)		3,736
 <u>Running Costs for OLC</u>		
Direct Staff Costs	1	12,754
Staff Driven	2	1,755
Accommodation	3	2,885
Other Fees	4	1,424
Irrecoverable VAT	5	1,044
Total Cost for OLC Running Costs		19,862
PwC Established Running Cost (2007-08 Prices)	7	17,621

Notes

1. This includes salaries, pensions and national insurance for all staff and board members.
2. These are costs relating directly to staff e.g. training and travel and subsistence.
3. All costs relating to the accommodation of staff including rent, rates and utilities.
4. Includes all other running costs e.g. Communications, provision of central functions such as HR and finance, pensions administration.
5. A 17.5% VAT provision on all non-staff costs per HMRC guidance.
6. All costs are stated in current 2007-08 prices.
7. Revised running costs are based on updated assumptions on case profiles and related staff changes and therefore are not directly relational to the original PwC work.