1. Introduction

1.1. This paper seeks views from the profession on proposals for Practising Certificate Fees (PCF) in 2017 in the context of the Bar Council’s proposed 2017/18 financial plans.

1.2. These PCF and budget proposals have been considered and approved by the Bar Council, following the recommendations of the Bar Council Finance Committee, a joint Bar Council and Bar Standards Board (BSB) committee including independent financial experts, and detailed reviews of BSB proposals by the BSB Board.

1.3. We intend, subject to consultation, to submit the proposals for the PCF to the Legal Services Board (LSB) for approval and, subject to that approval, to implement the changes in 2017.

2. Summary

2.1. We plan to set an operating budget that uses the current level of PCF collections to fund the organisation’s normal operating costs. Bar Council has, like other organisations, seen its defined benefit pension scheme, which operated from 1974 and closed in 2013, go into deficit. We propose to increase overall PCF by 12% to collect an additional £1.3M, wholly and exclusively to fund of this deficit. This will mean an increase in PCF of £13 for the lowest fees and £198 for the highest earners.

2.2. This paper sets out the rationale for these proposals, addressing the DB pension scheme issues in some detail.

3. Background to DB pension scheme

3.1. The Bar Council operated a defined benefit pension scheme (the DB scheme) for its employees from 1974 until it was closed in February 2013. The September 2012 valuation by the DB scheme’s actuaries, Aviva, showed a deficit of £2.8M. A
recovery plan was agreed between the DB scheme Trustees and Bar Council in Q1 2013 that was intended to meet this deficit by September 2019, at which point all parties expected the DB scheme to be self-sufficient with returns from assets meeting any future changes in liabilities.

3.2. The recovery plan included a levy on the Bar to provide funds for the scheme. The levy was imposed for practising certificate renewals between 2010 and 2013. The BC decided that the levy paid by individual barristers would depend on the number of years of call which overlapped with the scheme being in operation, e.g. in 2013 this was set at £3 per year of call. This levy raised £6.5M over the 2010 to 2013 period. This levy has proved to be inadequate in the current economic circumstances. This mechanism used to set a levy is no longer available since the move to an income based PCF model took effect.

4. The scheme is currently in deficit

4.1. The draft 2015 triennial valuation by Aviva was discussed with the Trustees in July 2016. It concluded that the DB scheme’s deficit had increased to between £3.7m and £5.4m due to significant increases in the pension liabilities, driven by low bond yields indirectly arising from low interest rates. The range of possible deficit values reflects uncertainties in the level and timing of future bond yields. We understand that many advisors expect these conditions to persist for the medium term and so it is likely that, without substantial and continuing increases in contributions, the DB scheme will remain in deficit for 10-15 years.

4.2. The triennial valuation report also shows the estimated cost of a buy-out at £16M. A buy-out is the transfer of the liabilities to an insurer for a one off premium to absolve the Bar Council of further liabilities. This estimated cost is up from £8M in 2012. Buy-out costs are a function of bulk annuity rates and so are closely linked to bond yields and interest rates. A scheme buy-out is not affordable at this time and so this option has not been considered further.

4.3. We are now facing a very significant deficit as a result of matters beyond our control. This is expected to persist for some time. Therefore the scheme is seriously underfunded at this point. This issue is not restricted to BC and there are several reports of low bond yields affecting the financial reporting of other organisations. The Pensions Regulator (TPR) publishes an annual report on the trends that are common to each cycle of those undertaking triennial valuations. The latest report shows that increased deficits are likely and that the median expected increase in recovery plan contributions is likely to be 75% to 100% of current levels.
4.4. The current Bar Council recovery plan included monthly contributions totalling £493,000 annually. The Bar Council has met the obligations utilising the residue of the 2010-2013 levy collections and in 2015 and 2016, its own reserves. We will no longer be able to continue this without very deep cuts to operating expenditure because we have used our reserves to absorb the recent financial losses. We therefore need to seek additional funding.

4.5. This matter is time critical because the TPR requires the Trustees to agree revised funding arrangements with the Bar Council, as employer and scheme sponsor, by the end of the calendar year. It is a legal requirement that we submit an agreed plan to TPR by the end of December 2016. Failure to agree a funding plan or non-compliance with an agreed plan risks regulatory action by TPR including:
- Statutory notices to direct employers to cooperate or to make payments;
- Imposition of fines to the employer; and or
- Imposition of interest charges on late or absent contributions to the scheme.

4.6. In summary, we need to raise approximately £5.4M over a period of up to 5 years to increase contributions to the scheme to meet the existing deficit by September 2021. This is more than the minimum level of funding required and will ensure we have a robust financial plan to deal with the scheme’s needs for the long term. It would also be prudent to continue to build a fund beyond that time to buy out future liabilities as they become affordable and deal with any other events that might impact the level of liabilities.

5. **Our proposal**

5.1. The proposal below has been prepared and reviewed in detail at each stage of our financial planning process. Options were considered by the General Management Committee and their views were used to shape the proposal put before the Finance Committee. The Finance Committee reviewed and unanimously recommended the proposal to Bar Council. Bar Council considered the proposal on 5 November 2016 and unanimously agreed that they are necessary.

5.2. We propose to increase PCF income by £1.3M annually by raising PCF fee rates 12%, beginning at the next renewal in 2017, solely to address the pension deficit. We will not seek to increase PCF for operational activities. The entire PCF increase will be wholly and exclusively for the benefit of the DB pension scheme. We expect to maintain this additional level of PCF until 2021, when the actuaries project the existing deficit would be cleared.
5.3. We would then aim to decrease the PCF levels to reduce collections to approximately £1.1M annually, allowing us to build a buy-out fund to discharge the pension liability completely. That might be in approximately 10 years or so, and much will depend on market movements. We would look to remove that £1.1M from the PCF altogether once we have been able to discharge the pension liability completely.

5.4. The proposed fees for 2017/18 are shown in Table 1.

<table>
<thead>
<tr>
<th>Band and annual earnings</th>
<th>2016</th>
<th>2017 proposed</th>
<th>*Change on 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Band 1 0-30k</td>
<td>£110</td>
<td>£123</td>
<td>£13</td>
</tr>
<tr>
<td>Band 2 30k-60k</td>
<td>£220</td>
<td>£246</td>
<td>£26</td>
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<td>Band 3 60k-90k</td>
<td>£441</td>
<td>£494</td>
<td>£53</td>
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<tr>
<td>Band 4 90k-150k</td>
<td>£803</td>
<td>£899</td>
<td>£96</td>
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<tr>
<td>Band 5 150k-240k</td>
<td>£1,219</td>
<td>£1,365</td>
<td>£146</td>
</tr>
<tr>
<td>Band 6 240k+</td>
<td>£1,652</td>
<td>£1,850</td>
<td>£198</td>
</tr>
</tbody>
</table>

*Fee increases are shown gross; increases net of tax range from £10 to £109

5.5. We proposed an increase in contributions to the DB scheme to £1M per annum from April 2017. This proposal has been accepted by the DB scheme trustees.

5.6. The entire additional sum generated by the increase in PCF rates will be used to fund a Bar Council Pension Reserve, a designated fund held separately from the general reserves and used exclusively for the DB scheme. We will make the annual contributions to the DB scheme from this reserve. We expect the reserve to build in value slowly by approximately £0.2M pa until 2021 and then more rapidly from that point onwards. This reserve would be the first port of call for increased contributions arising from future triennial valuations and provides the flexibility that our auditors require. We intend to report the movements within this reserve in our audited annual accounts to demonstrate good financial governance.

5.7. There is little risk of overfunding the scheme as Bar Council will retain control of the pension reserve. In the event that the scheme is over-funded, the scheme rules allow Bar Council to receive a reimbursement, which would reduce the PCF.

6. Budget plans

6.1. We propose to use the existing level of contribution from PCF, based on current fees collected, for the operational requirements of the BC and BSB. This means that
our 2017/18 operating budget will be level against the current 2016/17 expenditure plans. We will need to reduce our capital spend by £400K over the next two years however, to ensure that we manage our cash-flow effectively.

6.2. The PCF we collect also contributes to the costs of the operation of LSB and the Legal Ombudsman. We can meet these expected costs without changing PCF fees.

6.3. We intend to build in a contingency into our expenditure plans to cancel or defer activity and reduce costs if the PCF or other funding falls short of target. We did this in 2016/17 and it enabled us to react swiftly to changes in funding. In the event of a PCF shortfall, these cost reductions would be shared across the whole organisation.

7. Next Steps

7.1. We will finalise proposals in December in light of your responses to this consultation. Those proposals will be submitted to the LSB for consideration in December 2016. In parallel with this step, we will prepare detailed plans for scrutiny by Finance Committee in February 2017.

8. Budget Summary

8.1. Our financial strategy remains that we will seek to keep the PCF for operational costs level, absorbing small changes in funding needs through our reserves. We will also continue to invest our reserves to generate efficiency savings for the future. Finance Committee has judged that we have sufficient reserves to continue this plan but that we would need to monitor cash levels to ensure that the organisation retains sufficient liquidity.

8.2. We propose that the total expenditure budget for 2017/18 will be £13.9M, £0.4M lower than the 2016/17 budget and £0.1M higher than our latest forecast for the 2016-17 outturn. The proposals are shown in Table 2

- Headcount will decline against 2016/17 plans.
- Non staffing costs remain level.
- Overheads fall slightly.
Table 2 - 2017/18 Income and Expenditure Budget Proposals

<table>
<thead>
<tr>
<th></th>
<th>Bar Council</th>
<th>BSB</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>PCF Income</td>
<td>3,020</td>
<td>7,256</td>
<td>10,276</td>
</tr>
<tr>
<td>Non PCF Income</td>
<td>2,524</td>
<td>888</td>
<td>3,412</td>
</tr>
<tr>
<td>Total Income</td>
<td>5,544</td>
<td>8,144</td>
<td>13,688</td>
</tr>
<tr>
<td>Direct Costs</td>
<td>3,745</td>
<td>5,212</td>
<td>8,956</td>
</tr>
<tr>
<td>Overheads</td>
<td>1,871</td>
<td>3,043</td>
<td>4,914</td>
</tr>
<tr>
<td>Total</td>
<td>5,616</td>
<td>8,254</td>
<td>13,870</td>
</tr>
<tr>
<td>Change on 2016/17</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Budget (F)/A</td>
<td>(204)</td>
<td>(148)</td>
<td>(352)</td>
</tr>
<tr>
<td>Change on 2016/17</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Forecast (F/(A)</td>
<td>60</td>
<td>55</td>
<td>115</td>
</tr>
</tbody>
</table>

8.3. Table 2 provides a summary of the 2017/18 budget proposals.

Our plans will generate a small loss in the year, but we will grow cash levels slightly. This result allows us to maintain services, continue our investments and facilitates the investment to make an office move in 2018/19 to smaller premises.

- We will make a small operating loss of £182K but will accumulate £162k of cash, after capital investments and depreciation are taken into account.
- Our total free cash levels, the underlying cash levels after planned commitments are taken into account, will climb to an estimated £1.8m.
- Reserves will fall to 2.3 months of cover, below the indicative target of 4 months cover, i.e. covering 1/3rd the annual operating costs of the organisation. Finance Committee has judged that this level of cover is acceptable.

9. 2017/18 BSB Budget Proposals

9.1. The direct expenditure controlled by BSB will be £5.2M; £4.4M staffing and £0.8M non-staffing, and is level with 2016/17’s budget plans. Headcount is expected to settle at 82 in 2017/18, a reduction on the opening headcount of 84 in 2016/17. We estimate that £3M of shared overheads will be allocated to BSB. BSB expects to raise £0.9M (£1.2M in 2016/17 budget) of non-PCF funding.

9.2. This budget is for the second year of the three-year BSB strategic plan and demonstrates BSB’s strategic commitment to maintain the baseline of its direct operating costs, whilst striving for value for money, efficiency and cost reduction where possible.
The BSB expenditure plans include the following changes in 2017/18:

- Resourcing the implementation of the Future Bar Training programme with additional fixed-term contract resources.
- Implementing the Governance Review’s demands for improvements in staff capability and capacity.
- Support for a broad programme of research and policy work in regulatory areas.
- An enhanced communications and stakeholder engagement strategy which includes more consumer events and consumer research.

The BSB Strategic plan can be accessed here.

**10. Bar Council 2017/18 Budget proposals**

10.1. The direct expenditure budget of Bar Council (BC) will be £3.7M; £2.6M staffing and £1.2M non-staffing, and is £0.1M lower than 2016/17’s budget plans. Headcount is planned to be 3 lower than 2016/17 plans. We estimate that a further £1.9M of shared overheads will be allocated to BC.

10.2. The Services function will raise £2.5M (£2.4M in 2016/17 budget) from Bar Representation Fee (BRF) subscriptions and other services; the surpluses from these activities are used to both reduce the PCF burden and to enable BC to undertake activities outside of permitted purposes. It is critical to the funding of Bar Council that we increase BRF subscription levels, where the fee remains at £100 pa, to maintain the breadth of services for the profession outside of the narrow permitted purposes.

10.3. The BC operating budget supports the strategic plan shown here.

**11. Organisation wide budgetary and financial risks**

11.1. We see a range of risks that may impact on either Bar Council or BSB, or both, although in different ways. These may arise in 2017/18 and could lead to reductions in funding or increases in expenditure.

11.1.1. Reduced capacity to respond to change:

- Our overall reserves are smaller than they have been and there is little prospect of them growing in the short term before 2019. This reduces the contingency available to the business to absorb changes in funding (without changes in activity to compensate and reduce spend) or large, unplanned costs.
- We are leanly resourced and committed to two significant organisation wide change programmes that have a direct bearing on future expenditure.
11.1.2. Current drivers of potential change:
- There are a number of government and external reviews planned or underway, where the outcome is uncertain, that may impact the funding, operations or priorities of the organisation.

12. Financial Outlook beyond 2017/18

12.1. Table 3 provides a summary of the financial outlook beyond 2017/18 with indicative funding and expenditure forecasts to 2021.

12.2. It shows that the operating results of the combined BC and BSB will begin to improve from 2019 as the financial benefits of the current capital spend programme and the office move begin to be felt. This will in turn increase levels of reserves and free cash towards the previously established norms. Over time, this change will provide more capacity for the organisation to absorb financial risk and so provides more freedom to consider reducing operating PCF in the future. Reserve levels would likely have to increase above three months cover (i.e. covering ¼ of the annual cost of the organisation) before this opportunity becomes low risk enough to consider.

12.3. Table 4 shows how we expect the designated reserves, for the DB scheme, will build over time. We anticipate the total PCF requirements for the DB scheme will fall in 2021, after the existing deficit is met. This milestone will allow for the building up of a fund towards the long term to eliminate the DB scheme altogether. Therefore, if PCF collections reach target each year, the fund will grow by £0.2M pa until 2021 and then by £1.1M pa from that point reaching £2.3M by end of 2021/22.
Table 3 - Financial Outlook from 2017/18 Budget and beyond
Analysis of Reserves and Cash

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<tbody>
<tr>
<td>PCF Collections (for BC and BSB operating costs)</td>
<td>10,441</td>
<td>10,276</td>
<td>10,276</td>
<td>10,276</td>
<td>10,276</td>
<td>10,276</td>
</tr>
<tr>
<td>PCF Fee Increase towards DB Scheme</td>
<td>1,300</td>
<td>1,300</td>
<td>1,300</td>
<td>1,300</td>
<td>1,300</td>
<td>1,100</td>
</tr>
<tr>
<td>LSB &amp; OLC Fees</td>
<td>787</td>
<td>768</td>
<td>768</td>
<td>768</td>
<td>768</td>
<td>768</td>
</tr>
<tr>
<td>Total PCF Collections expected</td>
<td>11,228</td>
<td>12,344</td>
<td>12,344</td>
<td>12,344</td>
<td>12,344</td>
<td>12,144</td>
</tr>
<tr>
<td>PCF Paid to LSB/OLC</td>
<td>(787)</td>
<td>(768)</td>
<td>(768)</td>
<td>(768)</td>
<td>(768)</td>
<td>(768)</td>
</tr>
<tr>
<td>PCF transferred to designated fund</td>
<td>0</td>
<td>(1,300)</td>
<td>(1,300)</td>
<td>(1,300)</td>
<td>(1,300)</td>
<td>(1,100)</td>
</tr>
<tr>
<td>PCF retained for BC &amp; BSB operations</td>
<td>10,441</td>
<td>10,276</td>
<td>10,276</td>
<td>10,276</td>
<td>10,276</td>
<td>10,276</td>
</tr>
</tbody>
</table>

Non PCF Income
- Bar Council: 2,423, 2,524, 2,574, 2,574, 2,574, 2,574
- BSB Fees and Charges: 947, 888, 829, 779, 779, 398
- Inns Subvention: 250, 0, 0, 0, 0, 0
- Subtotal Non PCF Income: 3,620, 3,412, 3,403, 3,353, 3,353, 2,972

Expenditure
- Bar Council: 3,848, 3,745, 3,743, 3,782, 3,821, 3,861
- BSB: 5,213, 5,212, 5,146, 5,096, 5,162, 4,978
- Shared Overheads: 5,171, 4,914, 5,232, 4,640, 4,304, 4,304
- Subtotal Spend: 14,233, 13,870, 14,120, 13,518, 13,287, 13,143

Operating Surplus: (171), (182), (441), 111, 342, 105

Opening Reserves: 3,508, 2,844, 2,661, 2,220, 2,331, 2,673
- Operating Surplus: (171), (182), (441), 111, 342, 105
- DB Pension Charges: (493), 0

Closing Reserves: 2,844, 2,661, 2,220, 2,331, 2,673, 2,778
- Months of Cover: 2.4, 2.3, 1.9, 2.1, 2.4, 2.5
- Target: 4.0, 4.0, 4.0, 4.0, 4.0, 4.0

Adjustment for non cash items of capital spend and depreciation: (460), 345, 95, 545, 545, 545

Net Cashflow: (Surplus plus Adj): (632), 163, (346), 656, 888, 650

Opening Cash: 12,716, 12,084, 12,247, 11,901, 12,557, 13,445
Closing Cash: 12,084, 12,247, 11,901, 12,557, 13,445, 14,095
Free Cash (Uncommitted Cash): 1,668, 1,831, 1,485, 2,141, 3,029, 3,679

Table 4
Summary of Designated Reserves - DB Scheme

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>PCF Contributions received</td>
<td>0</td>
<td>1,300</td>
<td>1,300</td>
<td>1,300</td>
<td>1,300</td>
<td>1,100</td>
</tr>
<tr>
<td>Payments to DB Scheme</td>
<td>0</td>
<td>(1,000)</td>
<td>(1,000)</td>
<td>(1,000)</td>
<td>(1,000)</td>
<td>0</td>
</tr>
<tr>
<td>Closing Balance</td>
<td>0</td>
<td>300</td>
<td>600</td>
<td>900</td>
<td>1200</td>
<td>2300</td>
</tr>
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</table>

* BC income includes new income from Inns of Court towards BC activities.