Title: Standard Monthly Payment Reform **Lead department or agency:** Legal Aid Agency	Impact Assessment (IA)
	Date: 12/04/2023
	Stage: Engagement Exercise
	Contact for enquiries: smpreform@justice.gov.uk

Summary: Intervention and Options

What is the problem under consideration? Why is action or intervention necessary?

The Legal Aid Agency currently pays providers a Monthly Contract Payment via 2 separate methods: Standard Monthly Payment (SMP) and Variable Monthly Payment (VMP). The proposals aim to address the disparity between the 2 methods of payment, whereby providers still on SMP or who have transferred on non-express repayment terms are holding £21m of overpayments (as of September 2022). Failure to address means a continued dependence on a manual system of payment with a reliance on individual knowledge plus a significant debt balance held by a minority of providers who have been paid in advance of work done. This poses a financial risk to public funds and the proposal aims to reduce and remove the risk.

What are the objectives of the action or intervention and the intended effects?

The overall objective behind these proposals is to ensure a fair and equitable payment scheme where all providers are remunerated in the same way. The proposed contract change will address a significant debt balance of overpayments for work not actually completed and ensure the Legal Aid provider base operate sustainably based on payments made for work actually done in line with HMT Managing Public Money (MPM) principles. The change will also remove a barrier to a Digital payment system, where 2 separate methods of payment no longer need to be replicated and help to allow a move away from legacy IT systems.

The Engagement Exercise aims to understand the views of those affected before a final decision is made.

What options have been considered?

- Option 1: Remove SMP and all VMP held liabilities. Any overpayment to be repaid within 3 year period, commencing at the start of the next relevant Contract.
- Option 2: Option 1 but with additional repayment scope for not-for-profit providers and those providers that had a repayment plan agreed before 21 April 2023.
- Option 3: Remove SMP and all held liabilities. Repayments capped at 4% percent of total fund take or a maximum 10 year repayment period.
- Option 4: Do nothing.

Evidence Base

Background

1. The Standard Monthly Payment (SMP) protocol was agreed with the Law Society in 2008.

2. SMP is a system for paying for Controlled Work where providers are paid a fixed amount each month. Over time this may result in a gap between the actual cost of work done each month and the amount paid out under SMP.

3. Under the Protocol SMPs are paid 2 months in advance of claiming and create an aligned balance and unaligned balance for each provider.

4. A Provider is subject to a band (90% to 110% of aligned balance), and should they fall out of this band then a review is triggered. Protocol dictates their SMP would be reduced over a maximum period of 6 months to account for this variance in the aligned balance.

5. 90% of providers have moved to the LAA's Variable Monthly Payment Scheme (VMP) introduced in 2011.

6. Providers transferring from SMP to VMP between 2011 and 2013 were allowed to carry over a held liability of their non-aligned balance with no express repayment terms. This created held liabilities on VMP accounts.

7. As a central government agency, the LAA has a fiduciary duty to protect public funds by rebalancing the payment position, and to remove the risk of overpayments happening again. Her Majesty's Treasury's Managing Public Money (MPM) principles support and encourage compliance with that duty. The LAA has considered the following relevant MPM principles:

   - The net liability is a form of advance payment. Payments in advance of need should be exceptional (MPM A4.8.5). As only a subset of providers are using such payments, and other providers are demonstrating that providers can operate without this, there is not a strong argument that there is an exceptional need to continue this position.
   - Different payment approaches could distort competition in the market. Only a subset of firms hold a net liability or have a held liability. Competition promotes economy, efficiency and effectiveness in public expenditure (MPM A4.6.7).
   - Continuation of the SMP method without consideration of an alternative risks failing to address the LAA's duties under the principles of HM Treasury's (HMT) MPM.

8. The SMP process was expected to have a net neutral cost impact to Government, assuming that provider's accounts would fluctuate between being in an overpaid and underpaid state during the rolling review cycle that would largely offset each other across the piece. In reality, trends show that the rolling, non-aligned balance is consistently in a net overpaid state.

9. The total SMP balance has only ever been in an overpaid state since 2012.

10. SMP does provide occasional benefits, allowing the Legal Aid Agency to apply flexibility in exceptional circumstances. For example, it has helped with some recent immigration issues allowing a provider on VMP to move back to SMP and receive a fixed monthly sum.

It also allowed flexibility during COVID, whereby 6 providers transferred back to SMP from VMP to receive a fixed sum. 4 of these have reverted back to VMP.

11. It is a costly universal mechanism however and removing SMP will allow the Legal Aid Agency to develop more targeted and efficient approaches as contingency methods.

Rationale and evidence to justify the level of analysis used in the IA (proportionality approach)

12. The rationale for intervention in this instance is for both sustainability and equity. SMP as a method of payment is a legacy arrangement, that does not fit in with the MPM principles and disproportionately benefits 10% of providers.
13. The options detailed within this impact assessment aim to ensure fair remuneration for providers by bringing them all onto the same method of payment, whilst allowing a fair amount of time to reconcile any overpayments. The proposed changes would allow the LAA to explore further future changes within the monthly contract payment process, reduce the overreliance on legacy systems and a manual process and reduce the financial risk associated with payments in advance of work completed.

Description of options considered

14. To meet the objectives the following options have been considered
    - **Option 1: Remove SMP and all VMP held liabilities. Any overpayment to be repaid within a 3 year period, commencing at the start of the next relevant Contract.**
    - **Option 2: Option 1 but with additional repayment scope for not-for-profit providers and those providers that had a repayment plan agreed before 21st April 2023.**
    - **Option 3: Remove SMP and all held liabilities. Repayments capped at 4% percent of total fund take or a maximum 10 year repayment period.**
    - **Option 4: Do nothing.**
15. Any option would be implemented at the next appropriate contract and therefore will have different implementation dates for Civil and Crime.
16. Providers can choose to voluntarily move to VMP before implementation.

Risks and assumptions

17. An impact assessment was carried out between October 2022 and January 2023 using data compiled following the 20th of September submission period (August 2022 claims). The engagement exercise contains the most recent figures from February 2023.

18. The IA was utilised to develop the options above and contained within the engagement exercise document.

Financial

19. The total financial risk to the LAA by continuing to do nothing is a continued liability of £21.5m, with no mechanism or leverage to require repayment terms, held by only 20% of providers. This liability breaks down as follows:

VMP/SMP	Crime/Civil	Value of liability £m	Held by how many providers? (out of total number of providers with that category*)
SMP	Civil	3.1	72 (of 1367)
	Crime	10.1	194 (of 1041)
	Civil	1.1	54 (of 1367)

VMP (No Repayment Plan in place)	Crime	4.8	115 (of 1041)
VMP (Repayment Plan in place)	Civil	0.3	19 (of 1367)
	Crime	1.8	32 (of 1041)
Total		**21.2**	**424 (of 2075)**

* Providers may feature in both civil and crime.

20. For context, in September 2022, Civil monthly payments totalled £7.7m, of which £1.3m was paid via SMP (16% total payment). Crime monthly payments totalled £20.1m, of which £4.5m was paid via SMP (22% total payment).

Affordability analysis

21. Firms have been risk assessed specifically regarding the affordability of replacing the current funds from the LAA, with a loan at commercial rates. For the purposes of this analysis, we have assumed a loan rate of 10%. Firms fall into the following categories:

Risk level	Defined as potential loan interest costs as % of fund take of	Number of providers	Total liability £m
High	>=2%	24	1.2
Medium	1-1.99%	87	6.3
Low	<1%	313	13.7

Commercial Feasibility

22. It should overall be noted that 80% of providers are not currently benefiting from held liabilities or SMP non-aligned balances and are able to operate commercially without this agreement and funding from the LAA. Within that group, there is of course varied commercial performance, with some firms thriving and others failing. Options 1 to 3 would move the remaining 20% of providers to an equivalent commercial position by the end of this process.

23. We have considered commercial feasibility here, through the lens of whether a firm can realistically replace this funding with a commercial loan. A firm could choose to not replace the funding and repay through free cashflow; replace it through an injection of equity or through a loan. Not-for-profits may have lower access to loans but have alternative fundraising or grant options. The precise mechanism of funding is not the issue for affordability, rather the additional cost of capital is – this is shown in the affordability analysis on the previous page. We have considered a loan here for purposes of feasibility analysis, recognising that feasibility of raising a loan may be constrained by existing financing. For these purposes we have assumed a 10% interest rate – feedback during the engagement exercise on affordability and commercial feasibility may assist to review the reasonableness of that assumption.

24. As it is not possible to perform an in-depth analysis of all firms, the 24 firms in the high-risk category plus 1 Housing provider in the medium risk category with low provision **(25 in total)** were asked to provide their most recent accounts to assess the impact of removing SMP and requiring repayment of the associated debt for these firms. This approach is based on the latest available accounts, which may not be reflective of their current position and the limitations of this approach should be noted.

25. The remaining medium and low risk providers have not been analysed in greater detail as the affordability impact on them is lower (additional costs of <2% of fund take).

26. Analysis of the 25 high risk provider accounts shows the following:

- 15 firms are showing either no loans or are showing a balanced mixture of financing through loans and equity and are not heavily leveraged; and with cash in hand and are therefore at lower risk under these proposals.
- 3 were, at the time of the accounts, operating as a going concern but with liabilities exceeding assets, and may face difficulties regardless of this proposal. The debt held by these firms is at higher risk due to the more precarious nature of their finances.
- 3 accounts are showing as high risk due to high reliance on lending but having more assets than liabilities and/or showing a net profit.
- 2 did not tender for a 2022 Crime Contract and are repaying the debt balance following the end of the Contract.
- 2 firms have not yet supplied their accounts; one of which is already currently negotiating a repayment plan with us; and the other has a low absolute value of liability.

27. Overall, this analysis indicates that if we recoup the SMP/VMP debts, of the 21 firms analysed with the highest debts as a percentage of their fund take, we may see:

- 6 at high risk of closure, who are either already in a precarious financial position or may find they are unable to borrow further to maintain their position.
- 15 more able to sustain themselves through borrowing.

28. The financial position of any given firm is dynamic, and therefore this position may have changed since the annual accounts date and may change again if a longer time period is given for repayment. As such it should be considered indicative, but not predictive. As noted above, alternative sources of funds may also be available, such as directors providing equity.

29. Given the resource needed to analyse the financial position, and the limitation of financial accounts in reflecting the current position of firms, we recommend that commercial feasibility for low and medium affordability risk providers (and a further review on high-risk providers) would be best assessed through reviewing engagement exercise responses.

Analysis of debt versus fund take

30. We have assessed the potential monthly repayment per provider compared to their total monthly Legal Aid fund take, for different repayment periods. This indicates the pace at which a provider would need to replace the funds from the LAA, relative to the size of their fund take from us.

31. A range of repayment periods are noted below**.** At the lowest repayment period, 11% of firms (with a debt) would have repayment of more than 5% of their total fund take. This drops to 4% of firms under the most generous repayment period.

	Number of firms with repayment at a given percentage of fund take						
Repayment Period	**<1**	**1 to 4.9**	**5 to 9.9**	**10 to 24.9**	**25 to 49.9**	**50-99.9**	**100+**
36 Months	117	260	40	4	2	0	1
48 months	162	239	18	3	1	0	1
52 months	175	230	14	3	1	0	1
60 months	198	215	7	3	0	0	1

32. The above does not take into account any private income.

33. From this we can see that in all cases, most firms face a repayment of less than 5% of their fund take each month, and that there are a very small number of firms with large repayments proportionately. The balances of these accounts are all held liability from their historic transfer to VMP. The held debt reflects monthly values from 2012 and are higher than the current monthly payments.

34. The 7 firms above 10% on the 36-month recovery, have debt totalling £324,662. All of these are in the 25 high risk providers analysed above. 4 of these providers are not-for-profit providers:

- 1 is currently on a repayment plan longer than the most generous repayment period noted above.
- 1 considered high risk following financial assessment.
- The remaining 3 are funded through equity. They may still find it more difficult to replace the funding, if they are constrained from borrowing. Detail on this may be required through engagement.

Impact on provision

35. The 6 providers with the highest risk of closure (as noted in paragraph 27) pose no specific risk to provision. The analysis shows:

- 1 provider is Housing only but is in a procurement area with 6 other providers.
- 1 provider is Immigration only across 2 procurement areas. Each of these procurement areas has 6 other providers. This provider already has a repayment plan in place.
- 1 provider is Clinical Negligence only in a procurement area with 15 other providers.
- 3 providers are Crime only, in procurement areas with 4, 8 and 10+ other providers.

36. Housing Provision**.** 12 procurement areas in Housing, covered by 9 firms, could be left without provision in the event of a withdrawal from firms in scope of this proposal. Of these 12:

- 2 providers are classed as high risk in the affordability analysis.
  - One has no loans (financed through equity) and have a repayment plan in place for the debt. This provider is the only one within the procurement area. This risk could be mitigated by accommodating existing repayment plans.
  - The other is within a procurement area with 2 other providers who hold no debt. This provider has no loans (financed through equity) and has a high private fund take, compared to Legal Aid fund take.
- 1 provider is medium risk. They have no loans (financed through equity) and have a repayment plan in place.
- The remaining 6 providers (as some are in multiple procurement areas) are in the low-risk category.

37. Civil Provision. There is a further risk to Civil provision for 6 Family procurement areas and 24 Immigration providers.

- None of the Family providers are categorised as high risk. Should all affected providers withdraw, each procurement area would have at least one other provider in place. 3 schemes would be left with one provider only.
- Only 2 of the 24 Immigration providers are classed as high risk on affordability, and only 1 of these is high risk due to the amount of lending. South-West

- England and Wales procurement areas pose the highest risk, with the number of providers reducing to 5 and 7 respectively, should all affected providers withdraw.1 provider, operating in both of these procurement areas, is high risk as noted above.

38. Crime Provision**.** There is a risk to 2 Duty Solicitor schemes with less than 4 Duty Solicitors, and 2 Duty Solicitor schemes with less than 6 Duty Solicitors.

    - Only 1 provider is high risk, and 1 medium risk, both from schemes with 5 Duty Solicitors. The high-risk provider is low financial risk due to being funded through equity.

Other risks

39. Other material external and internal risks not covered in the analysis above are covered below.

Concentration risk / large provider risk

40. The risk posed by larger providers within those affected has been considered. Providers with over £5 million fund take have been included in this assessment.
41. There are 8 large providers within this sample, who hold 15% of the total debt balance.
42. 6 of these providers hold 48% of the total Civil debt.
43. 7 of these providers hold 7% of the total Crime debt.
44. 6 of the large providers have a repayment plan currently in place, all of which pay back more than that proposed under any option. These are considered low risk.
45. The remaining 2 providers, in the event of a full withdrawal, pose a risk to specific areas in immigration, public law and Crime due to their size. These would be immediate risks that may be resolved through other providers scaling up and is not considered a compelling argument to continue with the status quo given it benefits these firms to a disproportionate amount.

Operational risks of existing process**.**

46. There are significant operational risks associated with the current process, namely due to the highly manual and labour-intensive process that relies on a subject matter expert, and which is dependent on a legacy IT system (CIS). Digital work is ongoing but will be materially more complex if SMP and VMP continue to operate as currently. Removing SMP and associated debt will take away one of the main complexities in working towards a new digital payment system. Risk mitigation has been applied as much as possible, however the knowledge base for this system is contained by only 3 individuals currently (1 additional new member of staff to be trained).

Financial

47. The current arrangement is likely not one which would be approved internally if entered into now or would at least need HMT approval under Managing Public Money principles. Continuation of this without consideration of alternatives risks intervention from internal stakeholders (NAO, HMT) and an eventual change which is forced upon the LAA and providers. Providers can currently continue to request a move back to SMP further increasing the debt.

Wider impacts

Public Sector Equality duty (PSED)

48. PSED has been considered and we have insufficient information at this stage to fully assess the impact. We will consider how this can be raised through the engagement exercise and consider the impact of the proposal under PSED via the engagement responses. In particular we recommend that consideration of not-for-profit providers, and the groups they serve, is specifically addressed in the engagement exercise.

Sustainability

49. Removing the complex SMP process, heavily reliant on legacy IT systems and manual intervention, would assist with a move towards a simpler Digital payment system and meet the commitments set out in the Greening Government: ICT and digital services strategy 2020-2025.

Monitoring and Evaluation

50. Should any of options 1 to 3 be implemented we will continue to monitor the impact of these changes. Option 4 maintains the current process so no monitoring or evaluation would be needed.