

AGENDA ITEM

703 JULY 2016

DATE: July 21, 2016

TO: Members, Board of Trustees

FROM: Ricardo Goñi, Chair, California Board of Legal Specialization
Gayle Murphy, Senior Director, Admissions
Natalie Leonard, Director, Legal Specialization

**SUBJECT: RESERVE POLICY AND APPROPRIATE LEVEL OF RESERVE FOR
LEGAL SPECIALIZATION FUND**

EXECUTIVE SUMMARY

During its January 2016 meeting, the State Bar of California's Board of Trustees adopted a new reserve policy, which requires all State Bar funds to maintain reserves at the target rate of 17 percent and a maximum fund balance of no more than 30 percent. The Legal Specialization Fund Balance is significantly over the reserve policy maximum; thus, in accordance with the policy, which states that reserve balances in excess of 30 percent must be reduced, the California Board of Legal Specialization (CBLs) approved the following recommendations for consideration by the Board of Trustees relative to spending down the reserve fund balance.

BACKGROUND

The new reserve policy adopted by the Board of Trustees states the following:

Whenever reserve levels surpass 30 percent in either the General Fund, or any fund within the Restricted or Special Revenue Program Funds, for a consecutive six month period, they are considered to be materially above the target minimum level and subject to spend-down, with the exception of Sections Funds.

Spend-down shall occur in accordance with the following principles:

1. Fund balance spend-down should be utilized to offset member dues and other assessments and use charges, where possible.
2. Fund balance spend-down should be used to advance strategic efficiency investments that will result in short- or long-term reductions in operating costs.
3. Fund balance spend-down should be used to bolster the Client Security Fund, where possible.

Currently, the Legal Specialization Program reserve contains approximately \$5.4 million, and it is projected to reach approximately \$6.4 million by year's end. The program for certifying legal specialists is a special fund/separate fund program fully funded through fees taken in by the program. (See Cal. Rules of Court, Rule 9.35(e).) It does not have access to general funds of any kind, and the program pays indirect costs for State Bar services such as facilities, Human Resources, General Counsel, etc. Last year's indirect costs totaled \$425,892; total revenue was \$2,574,755; and total expenses were \$1,543,151.

A number of factors combined to create the fund balance that exists today. The first issue relates to a fee increase implemented in 2011 and 2012 based on the best data available at that time. In 2010, budgeted expenses versus revenue for the legal specialization program reflected a deficit of \$800,000, which would have significantly diminished the reserve that was available at the time. The program had not raised fees in over eighteen years, although costs had continued to climb.

It was thought at the time, that, since there had not been a fee increase for many years, some certified specialists might resign from the legal specialization certification program if fees were increased. Given this concern, the California Board of Legal Specialization (CBLs) determined that it would be preferable to increase the fee significantly, with the thought being that doing so would preclude the need for any additional increases for a number of years.

While originally a two-step fee increase over a two-year period to address the deficit was recommended, ultimately, the CBLs adopted a fee level that was somewhat higher and added several new fees to reflect the costs associated with those activities.

The Board of Trustees approved the fee adjustments as proposed by the CBLs. Attachment A shows the changes in fees charged to certified specialists from 2010 to 2012. The fees have not changed since 2012. Contrary to the speculation that fee increases would result in declining membership, increases in the number of attorneys seeking specialization as well as stabilization of the rate at which existing specialists continue to participate in the program, have been realized. As a result, the program's reserve has grown significantly.

Another contributing factor to the growth of the reserve has been that certain budgeted expense items have not occurred, including a publicity campaign delayed while social media guidelines were created. Other savings associated with the increased use of technology were also achieved.

In addition, there were significant non-recurring salary savings over a three-year period as several long-term employees transferred to positions outside of the Legal Specialization Department.

Before the reserve policy was adopted by the Board of Trustees, the CBLs had already adopted as one of its goals for 2015 the need to invest the fund balance and to revisit legal specialization program fees that were being charged due to the reserve that had grown beyond expectations. Once the reserve investment has been accomplished, a revised fee schedule will be proposed to the Board of Trustees.

DISCUSSION

During its March 2016 meeting, the CBLs established the following priorities for spending down the reserve and directed staff to create a plan consistent with these priorities:

Online Processing/Computer	35%
Social Media/Outreach	25%
Examination Banks/Preparation	20%
New Specialties	10%
Refund/Educational Credit	5%
Exam Fee Holiday	5%

After reviewing the recommendations proposed by staff during its June 2016 meeting, the CBLS approved a plan to invest approximately \$6 million, which would leave a compliant reserve or fund balance of approximately \$464,000, subject to the approval of the Board of Trustees. The following recommended initiatives reflect the priorities outlined in the table above, and include an additional item not originally contemplated by the CBLS in March:

1. 2017 Certified Legal Specialist Fee Holiday – \$1,666,000

The initiatives discussed by the CBLS during its meeting in March, if adopted, would not completely resolve the issue of the reserve. According to the policy adopted by the Board of Trustees, one of the primary ways to spend down a reserve should be to “offset member dues and other assessments.” Elimination of the annual legal specialist fee for one year would be consistent with the policy as well as provide benefits to all certified specialists in a neutral manner, and will accomplish the timely investment of the reserve needed to conform to State Bar policy.

2. Online Processing/Computer (Development of Admissions/Legal Specialization Case Management System) - \$1.5 million

The legal specialization program has already shown that technology can improve efficiency. Legal Specialization plans to invest in an Admissions Information Management System (AIMS), which will allow the legal specialization program to do online processing of applications, internal examination administration, and customer relationship management analysis and reporting. Note that the system is not currently scoped to offer candidates the opportunity to take the examinations online, though that option can be addressed under a separate initiative. A Request for Proposals for the new system is currently being finalized. Using recent proposals received for a new system for the State Bar’s Office of the Chief Trial Counsel, the estimated cost for a new AIMS is approximately \$1.5 million to \$2 million. The California Board of Legal Specialization recommends that the legal specialization program set aside \$500,000 for its portion, and loan the Admissions Fund \$1 million to support broader Admissions AIMS needs. Both groups would benefit from this method of financing the computer system that will help to create long-term efficiencies, increased reporting capabilities and user satisfaction. If the Board approves this approach, staff will return to the Board with loan repayment terms and conditions at its October meeting.

3. Social Media/Outreach - \$100,000

An initial capital funding is proposed to begin a social media campaign to the public and to attorneys. Social media is the most common means of communication today, and statistics show that, after personal referrals, consumers are most likely to search for an attorney online, and most attorneys manage their lives online.

There are several investments that must take place to ensure a strong foundation for digital communication. A new logo that can be used digitally must be created, and materials must be updated using this new logo.

In addition, a strategy must be created for the most common platforms, Facebook, LinkedIn, Twitter, and Instagram. A blog should also be considered as well.

Outside assistance is needed for logo creation, training of internal personnel on this new software, and architecture for the sites, as well as written and visual content.

It is recommended that a total of \$100,000 be set aside, with a portion of that sum to be used for logo and material redesign, and the remainder to be used to build and populate sites. Firms that specifically work with non-profits and government agencies have expertise in this area that can ultimately save the program money.

4. Examination Banks/Preparation - \$2,222,500

The CBLS also has the opportunity to transition examination drafting and grading to paid contractors, which will increase transparency, accelerate creation of examination question banks, allow exploration of online examination and grading, and potentially provide the opportunity to increase the frequency of the specialist examination from every other year to annually or even on-demand. The proposed banks would be of sufficient size to allow a release of past questions to assist candidates in their study for the legal specialist examination; there has been an increasing demand for this information from both candidates and test preparation providers.

There are three key components proposed for these initiatives, two of which will be supported by a reserve spend down: question drafting and technical infrastructure are to be funded through the reserve, while question grading will be addressed in the program's 2017 budget. After the questions are developed, contractors would need to be retained to pre-test the questions. Finally, a tool would need to be created to maintain the questions in a secure manner, and to generate examinations as needed.

a. Invest in Professional Drafters to Create a Question Bank

Bar examination questions are typically written by paid drafters and graded by paid graders. When the legal specialist examination was first created, professors drafted the questions. Along the way, the process changed, and volunteer commissioners now draft the examination questions with assistance from the Director for Legal Specialization and outside consultants. The volunteer drafters have been stretched as the demands on their time as practicing attorneys have grown, creating a need for increased flexibility. In addition, because Advisory Commission terms are four years, often the expertise a member has obtained during that time is lost when his or her term ends.

Industry experts suggest that the bank for each subject should contain at least 900 multiple-choice questions and 60 essay questions. The questions are estimated to be drafted at a cost of \$100 per multiple-choice question and \$500 per essay, consistent with the fees paid for Bar Examination question drafting.

Pre-testers would be paid to review the questions, estimated at a rate of \$250 per 10 multiple-choice or 1 essay question.

b. Sample Questions as an Examination Preparation Tool

The creation of a bank of questions would allow for the release of some questions for guidance and study, much as questions are released for the bar examination. New preparation tools could be developed in the form of a booklet or a mobile application for use by busy attorneys. The details and costs could vary, but an Internet search showed an average of \$250,000 for development of a mobile application, and it can be assumed that the development would be complex here since so many specialties are involved.

5. New Specialties - \$200,000

CBLS' mission includes continually exploring and potentially expanding the range of areas of the law for specialization. It is proposed that a portion of the reserve be used to explore, propose and develop up to two new specialties, and that \$50,000 be set aside for that purpose. A CBLS working committee would be established to advance this goal, and would consult with consumer protection groups, interested attorneys and State Bar Sections to develop proposals for CBLS consideration. If the CBLS approves the proposal for a new area of specialization, it would then be submitted to the Board of Trustees for approval. The process as contemplated would allow for five meetings per specialty, including public meetings to gain feedback and propose the requirements for the specialty.

It is also proposed that an additional \$150,000 be set aside to draft initial questions to allow the specialties to begin and to grow. Additional questions can be added as the individual certified specialties as they continue to gain members.

6. Exam Fee Holiday [Reduction] - \$318,000

In lieu of a total fee waiver for the October 2017 administration of the Legal Specialization Examination, it is proposed that the examination fee(s) be reduced and the laptop fee be waived. Applicants pay an examination application fee depending upon the time that they apply to take the examination, and the fee rises as the examination day approaches. Currently, the examination fees range from \$350 to \$750, plus a surcharge for the laptop option. It is proposed that the fee be lowered on a one-time basis to \$100 for applicants applying by April 30, 2017 to take the October 2017 examination, \$250 if applying by August 31, and \$350 if applying by October 1, the final registration deadline. Attachment B shows the proposed one-time examination fee reduction for the 2017 Legal Specialist Examination. If the laptop fee is waived on a one-time basis for the October 2017 examination, the program will forego approximately \$122,400 in revenue, but will still have the associated software licensing, electrical cabling, and printing costs associated with offering the laptop option. Examination fees were \$418,000 in 2015. It is expected that revenues would be approximately \$100,000 under this one-time fee adjustment, requiring an investment of approximately \$318,000 from the reserve. This is proposed to be a one-time cost.

FISCAL/PERSONNEL IMPACT

The amounts associated with spending down the reserve are as follows:

1. 2017 Certified Legal Specialist Fee Holiday	\$1,666,000
2. Online Processing/Computer	\$1,500,000
3. Social Media/Outreach	\$ 100,000
4. Examination Banks/Preparation	\$2,222,500
5. New Specialties	\$ 200,000
6. Exam Fee Holiday [Reduction]	<u>\$ 318,000</u>
Total Investment	\$6,006,500

This investment of just over \$6 million will result in a reserve of \$464,931, which is above the minimum and below the maximum required by the State Bar's reserve policy.

RULE AMENDMENTS

None.

BOARD BOOK IMPACT

None.

BOARD GOALS & OBJECTIVES

1. Ensure a timely, fair, and appropriately resources discipline and regulatory system

- g. Complete full implementation of the Auditor's 2015 recommendations.

- i. Design and implement a program of preventative education.

3. Improve fiscal and operational management, emphasizing integrity, transparency, and accountability.

- d. Reallocate funds to reflect expenditure review, new reserve policy, and other reengineering efforts.

BOARD RECOMMENDATIONS

Should the Board of Trustees agree with the proposal recommended by the California Board of Legal Specialization, the following resolution would be appropriate:

RESOLVED, that the Board of Trustees approves and adopts the California Board of Legal Specialization's proposal relating to spending down the Legal Specialization Fund reserve.

RESOLVED, that the Board of Trustees approves the Legal Specialization Fee Charges and Deadlines be revised in the form attached hereto for 2017.

ATTACHMENT(S) LIST

- A.** Table of fees charged to certified specialists from 2010-2012
- B.** Redlined Version of Proposed Legal Specialization Schedule of Charges and Deadlines
- C.** Final Version of Proposed Legal Specialization Schedule of Charges and Deadlines