

Annex 6

Economist's report

Assessment of the economic rationale for, and possible impacts of, proposed changes to the Solicitors Regulation Authority Handbook

FINAL REPORT

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Summary

This paper provides an assessment of the potential economic benefits and risks associated with the proposed changes to the Solicitors Regulation Authority (SRA) Handbook. It also considers some of the possible impacts on competition, innovation and the cost of legal services of the proposed changes, and how different parties may be affected by these impacts.

The key findings of this paper, in summary, are:

- i. Any assessment of the risk and benefits of regulatory changes must be made within the relevant market context. In this case, this requires consideration of any specific rationales for regulation of legal services, the substantial changes that are currently occurring in the legal services market in England and Wales (in terms of business models and delivery mechanisms), as well as the need to balance consumer protection regulation and competition in the context of these market changes. The assessment in this report is made with regard to these framing issues.
- ii. The SRA is proposing a suite of changes to its Handbook and related regulatory arrangements, some of which can be categorised as refinements of its existing outcomes-focussed regulatory strategy, and some of which are more fundamental changes to existing legal services regulation. Of particular importance in the latter respect is the proposal to allow solicitors to provide certain legal services to the public, or sections of the public, through entities that are not subject to legal services regulation.
- iii. In assessing this latter proposal it is necessary to understand the distinction between legal services involving 'reserved activities' and those that involve 'non reserved activities'. Reserved activities must always be delivered by regulated entities, although non reserved activities need not be. Solicitors are currently only able to provide legal services – including non reserved activities – to the public if the business they operate through is regulated by the SRA. By contrast non-solicitors may deliver non reserved activities to the public through entities that are not regulated by the SRA. The SRA proposes to align the treatment of solicitors and non-solicitors in this respect and allow solicitors to deliver non reserved activities to the public through non-SRA regulated entities (the SRA terms these 'alternative legal services providers').
- iv. Having regard to the contextual frame described above, our assessment of the economic rationale – in terms of potential in-principle benefits and risks – of the various proposed changes to the SRA Handbook are set out in table 1 below.
- v. In considering some of the possible impacts of the proposed changes on competition and innovation, and on different types of stakeholder (consumers, solicitors, providers), the important matter, from an economic perspective, is how the changes will impact on *behaviour*, which in turn has wider economic effects. Consistent with the general approach adopted in assessment exercises of this type, the possible impacts are examined relative to the current market and

regulatory/policy context. That is, impacts are assessed relative to a counterfactual where the Handbook exists in its current form, the SRA applies an Outcomes Focussed Regulatory (OFR) approach, and where there are both regulated providers (such as traditional solicitor practices and alternative business structures) and providers of legal advice who are not subject to legal services regulation. Table 2 summarises our assessment of the possible impacts of the various proposed changes on key economic variables.

- vi. The potential economic impacts identified can be mapped across to different types of affected parties. Our assessment of the possible impacts on consumers, solicitors, regulated providers and non-solicitor firms who provide non reserved activities is summarised in table 3.
- vii. These tables indicate, in general terms, that consumers can be expected to benefit from the proposed changes to the extent that they: widen the number of providers and delivery mechanisms available to consumers; allow consumers increased access to the high standards of professionalism and education that is provided by solicitors; improve consumer understanding of the legal services market; and allow some consumers to trade-off certain protections for other benefits. Moreover, to the extent to which the changes result in more intense competition and innovation, this might ordinarily be expected to benefit consumers in the form of lower prices, alternative pricing arrangements, higher quality and the introduction of new products and services. All of this might draw more consumers into the market and address concerns about unmet demand.
- viii. On the other hand, and again in general terms, some consumers may be adversely impacted by the changes to the extent that they fail to address, or increase, confusion around the different protections attaching to services provided by solicitors through regulated providers and alternative legal services providers, or if the professionalism of solicitors is eroded, or seen to be eroded, through practice in alternative legal services providers. As discussed in this paper, consideration will need to be given as to whether such risks can be mitigated by appropriate measures in implementation of the proposed changes.
- ix. Finally, as emphasised throughout this report, regulatory arrangements often involve a level of compromise between specialist consumer protections and competition. Accordingly, even where a potential risk cannot be comprehensively mitigated in implementation, such risk or outcome must be weighed against the extent and magnitude of any potential benefits for consumers that may be associated with the changes in terms of greater competition and innovation.

Table 1: Assessment of the economic rationale of the proposed changes

Proposal	Potential benefits	Potential risks
Restructure and simplify the Handbook	<ul style="list-style-type: none"> • Simplification, through fewer, and clearer, principles and standards, may enable regulation to keep in step with some of the wider market changes, in particular the increasing diversity of business structures. • Delineating the regulation of individuals from entities should assist the implementation of other proposed changes, particularly the change to allow solicitors to practice in alternative legal services providers. 	<ul style="list-style-type: none"> • May create material gaps in coverage leading to discord with policy objectives, and detrimental impacts on consumers. The extent to which this risk will arise will depend greatly on the content of the principles and codes of conduct and whether they are sufficient to cover all circumstances that may arise in practice, as well as whether the general principles are complemented by appropriate regulatory guidance. • If the simplification results in unintended changes to the established meaning or understanding of words and concepts, this might impact on the achievement of regulatory objectives.
Reducing Handbook size and removing redundant or duplicative requirements	<ul style="list-style-type: none"> • May improve understanding of solicitors, regulated providers and consumers of regulatory obligations and protections, and the basis on which enforcement actions and decisions are taken. This can enhance consumer confidence in the market and be market-expanding. • Allowing economy-wide legislation to provide consumer protections where these are sufficient for legal-services consumers will avoid regulatory duplication and should reduce regulatory costs. 	<ul style="list-style-type: none"> • May create material gaps in regulatory coverage. Mitigation of this will lie in the specifics of how this change is implemented.
Refining the outcomes-focussed regulatory approach and removal of non-binding guidance	<ul style="list-style-type: none"> • May create greater clarity for solicitors and regulated providers as to the status of different requirements. • Removing non-binding guidance from the Handbook should allow the new extrinsic guidance (e.g. online toolkits/case studies) to keep in step with changes in the market, and any specific problems that emerge. • May foster a mindset focussed on complying with regulatory objectives, and allow for new and innovative ways of compliance to develop across the diverse areas regulated. 	<ul style="list-style-type: none"> • May increase uncertainty among regulatees as to what actions constitute regulatory compliance. • Any such uncertainty could increase costs, and potentially foster growth in the third-party compliance industry. • However, solicitors and regulated legal service entities might be expected to be more equipped than other professions when it comes to dealing with generality in legal provisions or regulations.

Proposal	Potential benefits	Potential risks
Development of a series of public and business facing guides	<ul style="list-style-type: none"> • May empower consumers, by making it clearer which type of provider is most suited to their needs and requirements, and differences between providers in terms of service levels and protections. • More active and engaged consumers can expand the legal services market, and address some of the problems associated with unmet demand. 	<ul style="list-style-type: none"> • To be effective, careful thought will need to be given to the various target audiences of such guides, the information to be included and the accessibility of such information.
Allowing solicitors to deliver non reserved activities through alternative legal services providers	<ul style="list-style-type: none"> • May increase competition by allowing solicitors to capitalise on their specific qualifications, skills and expertise in alternative legal services providers. • May facilitate innovation and new methods of service delivery, which can be market-expanding and potentially address some of the issues associated with unmet demand for legal services. • Will expand the choice options for solicitors which could lead to an even more diverse legal market. • More opportunities for in-house providers to advise the public, or certain segments of the public, including vulnerable consumers (subject to their employment contracts). • Will 'level the playing field' for solicitors and non-solicitors who provide non reserved services. 	<ul style="list-style-type: none"> • Certain consumer protections will not be available where services are provided by solicitors through alternative legal services providers. (e.g. access to SRA Compensation Fund, regulated professional indemnity requirements and client money-holding rules). • Consumers may not have the benefit of legal professional privilege in relation to advice provided through an alternative legal services provider (unless novel contractual arrangements are developed). • Consumers may fail to understand relevant distinctions, and to appreciate differences in consumer protections when using different providers. • Certain entity-level business stability and viability protections will not be available to consumers that use solicitors through alternative legal services providers. • Consumers will not have the benefit of mandatory firm-wide conflict of interest protection (although firms may have voluntary policies which provide equivalent protections).

Table 2: Potential economic impacts of the proposed changes

Indicator/variable	Potential impact
Entry, expansion and exit	<ul style="list-style-type: none"> • If large numbers of solicitors do, over time, choose to deliver non reserved activities through alternative legal services providers, and consumers see these services as substitutes for those provided by solicitors operating through regulated firms, or by firms who deliver non reserved activities through non-solicitors, a material impact on entry, expansion, and therefore competition, can be anticipated. • Could encourage entry by new types of providers, such as legal technology firms. • There is also the possibility that the changes might result in some market exit. For example, if solicitors who deliver non reserved activities through alternative legal services providers directly challenge, and attract a significant volume of business away from smaller regulated providers, or from firms who deliver similar services through non-solicitors. • Impact on entry and exit could be reduced if consumers place a high value on the protections only available through regulated providers, or if the new arrangements would severely compromise legal professional privilege and such privilege has high value to consumers (generally, or in relation to certain legal services e.g. tax advice)
Costs and prices	<ul style="list-style-type: none"> • The potential impacts on costs, and therefore prices, are likely to vary according to the effectiveness of measures introduced alongside each proposal (e.g. whether the online resources and toolkits are more effective in allowing solicitors to understand what they need to do to comply with regulatory principles and objectives). • It will also depend on the intensity of competition, and therefore the extent of any pass-through of cost changes into consumer prices. • The cost impact of the refinement of the outcomes-focussed approach will depend significantly on the extent to which such change reduces regulatory uncertainty. • Public and business facing guides should reduce consumer search costs and allow consumers to exert greater service and pricing pressure on legal service providers. • It is difficult to identify a direct cost impact of the proposals to allow solicitors to deliver non reserved activities to the public through alternative legal services providers. However, the proposed change might result in reduced prices to the extent to which it intensifies competition in non reserved activities, or leads to entry by new providers with lower costs. • On the other hand, consumers who suffer loss as a result of fraud by, or the inadequate insurance of, a solicitor in an alternative legal services provider, will not have access to the SRA Compensation Fund in relation to this loss (which is a cost to those consumers who would have been eligible to fund protection).
Quality	<ul style="list-style-type: none"> • Public and business facing guides could reduce the information asymmetry that some consumers of legal services face, and increase the countervailing power they can exercise in dealing with legal providers. Other things equal, more empowered and knowledgeable consumers should be able to demand higher quality services from legal providers.

Indicator/variable	Potential impact
Quality (continued)	<ul style="list-style-type: none"> • Allowing solicitors to deliver non reserved activities through alternative legal services providers could potentially lead to higher quality provision of non reserved activities (relative to them being provided by a firm who does not employ solicitors). However this depends on whether these services are considered by consumers to be a substitute for these same services provided by non-solicitors. • Some concern has been expressed that solicitors acting in alternative legal services providers may face fewer quality constraints than in regulated providers, or face pressure to provide poorer quality service. Whether or not this proves correct, the proposed Solicitors Code of Conduct should, if effectively drafted and enforced, condition the minimum standards expected of solicitors wherever they practise. • Solicitors working through alternative legal services providers will not be subject to entity-level supervision of quality. The significance of this will depend on the extent to which the SRA adapts its supervision toward the individual level. • There may be quality impacts for consumers if legal professional privilege is not available in relation to services provided by alternative legal services providers. Similarly, there may be quality impacts of consumers not having the benefit of automatic firm-wide conflict of interest protection.
Innovation	<ul style="list-style-type: none"> • The refinement of the outcomes-focussed approach to regulation might foster innovation in compliance and create conditions for technological innovation by allowing those subject to regulation the freedom to experiment with alternative processes and technologies, which might lower production costs or improve quality. However, such changes could also potentially chill innovation if they create greater uncertainty. • Allowing solicitors to deliver non reserved activities through alternative legal services providers may provide opportunities for innovative service bundling for consumers, and other innovations in service delivery commensurate with the potentially great variety of non-law firms' business models. This could include the development of new methods of accessing legal services (e.g.: legal exchanges).
Demand for legal services	<ul style="list-style-type: none"> • Public and business facing guides could improve consumer understanding of their rights and obligations, instil a higher degree of confidence in the legal service market, and reduce search costs. This could encourage more consumers to purchase legal services. • Allowing solicitors to deliver non reserved activities through alternative legal services providers could, in principle, lead to a greater number and diversity of providers of regulated legal services. Some of these providers might introduce new delivery mechanisms – for example, through retail outlets or via the Internet – which could tap into unmet demand for a service of regulated quality provided through less intimidating or more convenient avenues. • Some current providers might exit, particularly smaller providers, which could potentially have impacts on demand and access to justice if the exit of such providers is concentrated in specific geographical locations or particular customer segments.

Indicator/variable	Potential impact
Wider economic impacts	<ul style="list-style-type: none"><li data-bbox="461 280 1980 368">• To the extent to which the proposed changes remove unnecessary restrictions on trade, this may result in the development of alternative delivery mechanisms and service provisions which might reduce the time and cost associated with acquiring legal services and lower transactions costs.<li data-bbox="461 376 1980 456">• Conversely if the proposed changes increase confusion and uncertainty this could reduce confidence in the legal services market and could increase transaction costs.

Table 3: Possible impacts on various affected parties

Affected party	Potential positive impacts	Potential adverse impacts
Consumers	<ul style="list-style-type: none"> • Consumers could benefit from the proposed changes to the extent that they: improve consumer understanding of the legal services market; widen the number of providers and delivery mechanisms available; increase access to the high standards of professionalism and education that is provided by solicitors; and allow some consumers to trade-off some protections for additional benefits. • If the changes result in more intense competition and innovation this could benefit consumers in the form of lower prices, alternative pricing arrangements, higher quality and the introduction of new products and services. This could also draw more consumers into the market and address concerns about unmet demand. 	<ul style="list-style-type: none"> • Consumers who suffer loss as a result of fraud by, or the inadequate insurance of, a solicitor in an alternative legal services provider, will not have access to the SRA Compensation Fund in relation to this loss. They will have access to avenues of redress available to all consumers. • Consumers may not have the benefit of legal professional privilege in relation to advice provided through an alternative legal services provider (unless novel contractual arrangements are developed). • Consumers may be confused by the different protections attaching to services provided by solicitors through regulated and alternative legal services providers, and may find it difficult to make informed decisions. • A concern raised in some quarters is that consumers may, for reasons associated with the loss of entity-level supervision, receive lower quality services from solicitors in alternative legal services providers. • Consumers will not automatically have the benefit of firm-wide protection in relation to conflicts of interests with other clients of the provider.
Solicitors	<ul style="list-style-type: none"> • The specific impacts on solicitors are likely to differ according to the structure through which they deliver legal services, and how responsive they are to the changes (i.e.: whether they see them as an opportunity). • Changes to the structure and content of the Handbook could result in benefits for solicitors by clarifying their regulatory obligations, reducing their compliance burden (by removing duplicative or redundant requirements) and allowing them greater freedom and agency in determining how to comply with various principles and standards. 	<ul style="list-style-type: none"> • There is potential for misunderstanding of the new compliance arrangements, although solicitors should be better equipped than most to understand, and deal with, regulatory changes. • The replacement of detailed indicative behaviours may create additional work for practitioners in determining how best to exercise their permitted discretion to best meet regulatory outcomes in their particular circumstances, increasing the costs and time associated with compliance.

Affected party	Potential positive impacts	Potential adverse impacts
Solicitors (continued)	<ul style="list-style-type: none"> • Refinements of the outcomes-focussed approach should reduce the frequency with which changes to the Handbook are made, and therefore the need for solicitors to constantly keep abreast of such changes. • Removing restrictions on the ability of solicitors to deliver non reserved activities to the public outside regulated providers could benefit solicitors by increasing the scope for them to leverage their specialist skills, knowledge and expertise into new areas, and through alternative providers and delivery mechanisms. This is likely to particularly benefit solicitors who are responsive to consumer needs and preferences. • The 'solicitor' brand could be strengthened by increasing the visibility and accessibility of solicitors, and improving understanding of the specialist skills and knowledge they can offer. In addition, if solicitors come to be perceived as less 'elite', this may widen access and attract more consumers to use their services. 	<ul style="list-style-type: none"> • There is a concern in some quarters that solicitors working in alternative legal services providers might face pressure from such providers to 'cut corners' or compromise their professional principles in the interest of commercial expediency. While it is not possible to predict whether such a conflict may arise, the solicitor themselves should, as the regulated party, have strong disincentives to compromise the professional principles to which they will remain subject under their Code of Conduct. • The 'solicitor' brand could be diminished as solicitors come to be associated with different type of providers and with varying levels of consumer protections. This will depend on consumer expectations of what is included in the provision of solicitor services, and the value they attribute to different aspects of this.
Regulated providers	<ul style="list-style-type: none"> • Proposals to simplify and remove duplicative and redundant requirements should benefit regulated providers by reducing complexity, and potentially the regulatory burden on regulated providers. • Allowing individual solicitors to deliver non reserved activities to the public by practising in an alternative legal services provider may have impacts in terms of attracting and retaining staff, and some solicitors may decide to deliver solely non reserved activities through an alternative legal services provider. • Could have impacts in terms of the ability to compete with alternative legal services providers, particularly those with strong consumer brand recognition. 	<ul style="list-style-type: none"> • The potential impacts on regulated providers will differ according to their size, location and the relative proportion of reserved and non reserved activities they undertake. • The potential impact on smaller traditional regulated providers is more difficult to assess. Some changes have the potential to reduce the burden and costs associated with complying with regulation. However, the ability to deal with the competitive threat of solicitors working in alternative legal services providers may be more limited for smaller providers as, for various reasons (such as their location) they may have to continue to deliver both reserved and non reserved activities.

Affected party	Potential positive impacts	Potential adverse impacts
Regulated providers (continued)	<ul style="list-style-type: none"> • Larger providers, and those which target business customers, are likely to be best placed to adapt to changes in the legal services market. Some of the more innovative providers may see this as an opportunity to introduce new compliance and delivery methods. • Some currently regulated providers may choose to focus only on non reserved activities in the future, and therefore avoid the costs and obligations of entity regulation. 	<ul style="list-style-type: none"> • If re-writing the Handbook changes the meaning of words and concepts, this can have cost and training implications for regulated providers.
Firms who provide non reserved activities through non- solicitors	<ul style="list-style-type: none"> • Most of the proposed changes – in so far as they relate to regulatory requirements and obligations – will not impact on firms who deliver ‘legal services’ through non-solicitor advisors. • However, alternative legal services providers, who use solicitors to deliver non reserved activities under the changes, may benefit from offering a differentiated service to firms who provide the same services through non-solicitors. • Such providers will also have the potential to ‘opt-in’ to regulation. The incentive to do so might arise for cutting-edge or innovative providers who want to reassure consumers that they are subject to various controls and processes, and that service users will be afforded traditional protections, including the benefit of legal professional privilege. 	<ul style="list-style-type: none"> • Firms who deliver non reserved activities through non-solicitor advisors will, under the changes, potentially face more intense competition for some of these services from alternative legal services providers. • The extent of this impact will depend on how substitutable the two types of services are. Such increased competition itself is not an economic risk, but could be so if the provision of certain services by non-solicitors discontinued in the market in circumstances where consumers did not, or could not afford to, then obtain those services from solicitors.

1. Introduction

1.1 Purpose of the research

The legal services market in England and Wales is experiencing a period of change. New business models and delivery mechanisms are being developed, and the number of providers of non reserved activities who are not subject to legal services regulation is growing. Consumers are also changing how they select and buy legal services, and the funding of key aspects of legal services (such as legal aid) is subject to review. Technological change is also having a major impact on the sector. Notwithstanding these changes, questions continue to be asked about the affordability of legal services, levels of consumer satisfaction, and whether there might be rules in place that reduce competition and innovation to the detriment of consumers.

Regulation can be either a facilitator or inhibitor in times of change. Well-designed, proportionate and targeted regulations can foster high levels of competition, innovation and consumer satisfaction, and allow for the achievement of other policy objectives. Conversely, regulations that are poorly designed, overly restrictive, insufficiently targeted, disproportionate or inadequately enforced, can be inimical to competition, innovation and consumer satisfaction and can frustrate the achievement of other policy goals.

Accordingly, a central challenge for all regulators and policy makers is to develop a set of regulations, and regulatory institutions, that are ‘fit for purpose’ given the market context – i.e.: regulation that is well targeted to policy goals, cost-effective, proportionate and that complements wider changes in the market.¹ The question is therefore not simply one of ‘more or less’ regulation, but rather about developing the best set of regulations to match the market context in which they are being applied. This requires regulators, and those subject to regulation, to remain vigilant in identifying regulations that will facilitate or frustrate developments which might improve competition, innovation and consumer outcomes, including, in this case, access to high quality legal services.

Against this background, this paper considers a series of proposed changes to the Solicitors Regulation Authority (SRA) Handbook. In particular, the focus of this paper is on assessing the economic rationale for, and possible impacts of, these proposed changes. In this respect, it is intended to assist the SRA to determine whether the proposed changes are supported by robust economic rationales, and are likely to complement, rather than frustrate, wider positive changes that are occurring in the legal services market.

¹ This accords with the general principles of Better Regulation such as the EU’s SMART requirement – that regulatory objectives should be ‘Specific, Measurable, Achievable, Relevant and Time-bound’.

Specifically, this paper seeks to address two general questions:

- Firstly, what are the, in-principle, potential economic benefits and risks associated with each of the proposed changes? (i.e. how compelling is the economic rationale for each)
- Second, what are some of the possible economic impacts, including on competition, innovation and the cost of legal services of the proposed changes? How might different affected parties be impacted by the proposed changes?

1.2 Approach

In responding to the questions, the analysis in this paper draws on a wide range of materials including: policy-documents; regulatory consultations; reports; academic papers and other documents. The material also draws on discussions with the SRA and other key stakeholders such as the Legal Services Consumer Panel, the Law Society, the Law Society in-house division, the City of London Law Society and specific regulated and non authorised providers. The purpose of these discussions was to hear first-hand the factors that are motivating the changes to the Handbook, and to explore possible impacts of the changes.

Consistent with the general approach adopted in assessment exercises of this type, the analysis examines the rationale for, and possible impacts of, the proposed *incremental* changes to the SRA Handbook. Put differently, the focus is on analysing the proposed changes relative to the current market and regulatory policy context. This is relevant insofar as it means that the impacts are assessed relative to a counterfactual where the Handbook exists in its current form, and where the SRA applies an Outcomes Focussed Regulatory (OFR) approach. Impacts are also assessed relative to a market context where there are regulated providers (such as traditional solicitor practices and alternative business structures) as well as a large number of non authorised providers of legal advice.

In the time available, the two key research questions have been addressed at a general level, drawing on general economic principles and insights to identify the likely type and nature of effects that might follow from the proposed changes. As such, the research does not seek to quantify, or provide detailed empirical evidence to support, the conclusions made.

1.3 Structure of the paper

This paper comprises six additional sections. Section 2 sets out the changes being proposed to the SRA Handbook. Section 3 situates these changes in the wider market and policy context, and discusses some of the main characteristics of the demand for, and supply of, legal services in England and Wales, as well as some of the most important changes that are impacting on this market. Section 4 sets out some general considerations that are important to frame the analysis in this paper. It briefly considers foundational questions such as: Why do we regulate legal services? What is the

appropriate balance between consumer protection laws and competition? What are the merits of alternative regulatory approaches to achieving a set of objectives? Section 5 assesses the rationale for the proposed changes, identifying some of the, in-principle, potential benefits and risks associated with the changes. Section 6 builds on this analysis, to consider and map out some of possible impacts of the proposed changes on competition and innovation, and on different affected parties (consumers, solicitors, providers). Section 7 builds on the analyses in these earlier sections to address a set of key questions identified by the SRA, including:

- i. What might be the effects of the proposed changes in terms of competition, costs for the consumer, choice and market growth?
- ii. Are there likely to be any negative or unintended consequences associated with the proposed changes?
- iii. Which legal services are likely to be most affected by the increased presence of solicitors being allowed the flexibility to provide legal services in a wider range of firms?
- iv. How might the proposed changes improve access to legal services for the public and business users?
- v. In what circumstances might a consumer decide to choose a 'qualified' professional in an alternative legal services provider?
- vi. What are the best ways to support consumer confidence to make effective purchasing decisions as the SRA opens up the range of options for choosing and buying legal services?
- vii. What might be the impact of these proposals on vulnerable legal consumers?
- viii. Will the proposed changes likely reduce the cost of delivering legal advice, and if so, are these cost reductions likely to be passed on to consumers?
- ix. What are the possible impacts on regulatory compliance costs (transitional and ongoing) of simplifying the handbook and changing our approach to guidance for firms? Will they differ between different types and sizes of firm?
- x. How might allowing solicitors to work across an expanded legal services market improve the diversity of the profession? Is it possible to identify groups that will benefit and also those to whom the proposed changes will have a less apparent or non-existent effect on their careers and advancement?
- xi. Is there likely to be a geographic dimension to the impact of the changes?

2. What changes are being proposed?

This section sets out our understanding of the changes being proposed by the SRA and the wider policy agenda in which these proposals are being made.

2.1 The SRA's new approach to regulation

Justifying why a regulation is needed, rather than why it should be removed

Considerable change to the regulation of solicitors and entities has occurred since the creation of the SRA a decade ago. The major changes include: a shift from a prescriptive, rules-based, approach to regulation to a more principles-based, outcomes-focussed, regulatory approach; the introduction of licensing for Alternative Business Structures (i.e.: structures which allow for non-lawyer ownership, management and control of authorised legal entities); and allowing the formation of multi-disciplinary practices, where a single firm can deliver both legal services and other services.

While these changes have been important, particularly in terms of the development of a more diverse set of legal providers, the SRA has acknowledged that there remain areas where regulation could be improved to better promote competition and improve access to justice. Specifically, the SRA has noted that the current regulatory arrangements are, on balance, too interventionist, and that some interventions cannot be adequately justified.²

Accordingly, a key element of the SRA's new approach to regulation is to shift away from an approach where justification is required only for removing regulations, towards one where all existing and proposed regulations are well-justified.

Clarifying who and what is regulated by the SRA

The current approach to regulation of solicitors comprises two parts. One part involves the regulation of entities, and includes placing restrictions on permitted business structures through which legal services can be provided by solicitors. A second part involves the regulation of individual solicitors, and, among other things, places restrictions on where they are able to practise as a solicitor.

An overarching aim of the SRA's changed approach is to separate out, and make clear, what requirements are placed on individuals who act as solicitors and what requirements are placed on entities that are authorised by the SRA. Specifically, the SRA is proposing to remove some of the regulatory restrictions that are placed on individual solicitors in terms of which businesses they can operate through. This will allow solicitors to provide non reserved activities through different types of business structures, including businesses that are not regulated by the SRA or any other approved legal regulator (the SRA terms these 'alternative legal services providers').

The aim of the SRA's changes is to bring about a situation where:

² Solicitors Regulation Authority (2015a).

- Solicitors are able to work on their own, or in a range of business structures, including businesses not regulated by the SRA. However, irrespective of the type of business through which they operate, all solicitors will be personally bound by a set of core regulatory obligations and professional principles.
- Entities providing legal services are able to structure themselves in any way that best meets their client and business needs provided that this accords with statute. An important statutory limitation in this respect is that certain specific types of legal services ('reserved activities'³) can only be provided to the public through an entity regulated by the SRA (or other approved legal regulator.)

An important factor motivating the proposed changes to the Handbook (described below) is to improve the clarity about who is regulated and what is expected of them. Specifically, under the proposed changes to the Handbook:

- *Individuals* are regulated against the title solicitor.
- *Firms* that provide legal services that involve reserved activities are subject to entity regulation by the SRA.
- *Managers and compliance officers* within SRA-regulated firms are subject to certain responsibilities.

In relation to these new arrangements, the SRA is proposing two 'Codes of Conduct': a SRA Code of Conduct for solicitors, Registered European Lawyers and Registered Foreign Lawyers; and a SRA Code of Conduct for Firms (solicitors, managers and compliance officers within firms). As described below, the SRA is also proposing a number of other consequential changes to the Handbook to effect this, and other aspects of, its new model.

2.2 A proposed new 'model' of regulation

In a November 2015 Position Paper the SRA set out its current thinking on a new model for regulation. There are five key elements of the proposed model:

- First, all solicitors are subject to core regulatory principles and obligations at all times.
- Second, if delivering reserved legal activities to the public or a section of the public, solicitors must do so through an authorised entity (a 'regulated provider'), such as a law firm or an Alternative Business Structure.
- Third, individual solicitors may deliver non reserved activities to the public or a section of the public by practising in an entity that is not regulated by the SRA (an 'alternative legal services provider'). If they do, regulatory protections such as access to the Legal Services Ombudsman and complaints handling obligations will continue to apply. However, it is proposed that regulatory protections such as access to the SRA Compensation Fund, regulated

³ A detailed discussion of the types of legal work comprising reserved and non reserved activities is contained in section 3.

professional indemnity insurance requirements and client money-holding rules will not be available in relation to these services.

- Fourth, an entity (i.e. an organisation) may be authorised by the SRA to deliver reserved activities, but although then entitled to do so, it will not need to deliver reserved activities to retain its authorisation.
- Fifth, any entity authorised by the SRA which delivers reserved or non reserved activities must have appropriate indemnity insurance; may hold client money subject to proper systems being in place; and will have obligations and protections under the SRA compensation arrangements.

The SRA's vision is a market where business and individual consumers can choose between a diverse range of providers of non reserved activities, including: solicitors working in regulated entities; solicitors working in alternative legal services providers; or firms who do not employ solicitors to deliver non reserved activities.

The current changes are part of a wider programme of review by the SRA of its regulatory approach. It proposes to undertake its review of regulation in two phases. The first phase focuses on how solicitors and firms can practise, and the behaviours, conduct and standards expected of them. The second phase, which is in the early stages of development, will focus on the remaining areas of the Handbook.

As part of this first phase, the SRA has also reviewed its outcomes-focussed regulatory strategy, and considered how elements of the implementation of the strategy might be improved. Based on this review, and in order to implement its proposed new model of regulation, various changes have been proposed to the current version of the Handbook⁴ and to the SRA's regulatory approach more generally.

2.3 The SRA's proposed changes

The SRA's proposed changes can be categorised as involving the following:

- *Simplifying and restructuring the Handbook*: The aim of the restructure is to create a clearer separation between regulations that apply to solicitors as individuals, and regulations that apply to authorised entities. In terms of simplification of the Handbook, it is proposed that the number of principles and outcomes that solicitors and firms must follow as part of their respective Codes of Conduct be reduced.
- *Reduction in Handbook size and removal of redundant requirements*: It is expected that the size of the Handbook will be substantially reduced to around 50 pages from its current size of around 400 pages. Some of this reduction in size will come from the removal of requirements that are covered by other laws and regulations or which have been superseded by market or technological developments. The aim is to make the rules sharper and better focussed.
- *Refinement of outcomes-focussed regulatory strategy, including replacing non-binding Indicative Behaviours and guidance*: An overarching aim is to establish a minimum set of standards which account for the diversity of the profession,

⁴ Version 15 of the SRA Handbook published on 1 November 2015.

and the various forms of business structure, and are relevant and applicable to all regulated individuals and providers. Indicative Behaviours, which are currently contained in the Handbook, are to be replaced with on-line resources such as case studies and toolkits. The proposal is to have a clear separation between binding rules and non-binding guidance.

- *Development of public and business facing guides:* These are intended to help consumers understand what protections they have in dealing with solicitors and the different types of providers, to clarify standards of service and conduct they can expect of a solicitor, and to develop tools to help choose the right legal services for their needs.
- *Removal of restrictions on solicitors delivering non reserved activities outside regulated providers:* This will allow individual solicitors to deliver non reserved activities to the public, or a section of the public, through an entity that is not subject to legal services regulation (an 'alternative legal services provider').

3. The wider market and policy context in which the changes are being proposed

Before going on to consider whether the changes being proposed to the SRA Handbook have a well supported economic rationale, and the possible impacts of such changes, it is useful to situate the proposed changes in the wider market and policy context. This is because, as discussed earlier, regulation can only be appropriately assessed by reference to the context in which it is being introduced.

This section begins by setting out some of the main characteristics of the current structure of the demand for, and supply of, legal services in England and Wales. It then briefly describes some of the most important changes that are impacting on this market.

3.1 Current market context

Market size

The UK has the largest legal services market in Europe. In 2012 it was estimated that the legal sector was worth over £20 billion, and contributed around 1.5% to UK GDP, including £4 billion of export value.⁵ Moreover, since that time, the market has grown and in 2014 it was estimated that the total turnover of legal activities (including activities of barristers, solicitors and patent and copyright agents) was £30.05 billion.⁶

Table 1 below shows the estimated turnover associated with the activities of solicitors over the period 2010 to 2015 based on ONS data.⁷ Of particular note is that the turnover of solicitors is growing, and indeed, has grown by 16% over this five-year period.

Table 1: Turnover of activities of solicitors, 2010 -14

	Activities of solicitors £ billion
2010	13.98
2011	15.15
2012	15.81
2013	16.88
2014	16.28

Source: Office of National Statistics (2015)

It is difficult to assess the overall size of the 'unauthorised' legal services market (see definition below). Some estimates suggest that the turnover of the unauthorised market could be in the vicinity of 20% to 30% of the total market.⁸ Assuming that the turnover associated with regulated activities of £30.05 billion is reasonably accurate, this implies that the turnover of the unauthorised market would be in the vicinity of £6 billion to £9 billion in 2014. This compares to turnover of solicitors of £16.2 billion in that year.

⁵ See Wright (2014).

⁶ Office of National Statistics (2015)

⁷ Office of National Statistics (2015)

⁸ See Cross (2014).

Types of provider of legal services

Existing providers of 'legal services' can be classified into three categories:

- a. Those who are authorised and regulated by an approved regulator under the Legal Services Act 2007 (LSA) to provide legal activities.
- b. Those that conduct certain legal activities – such as claims management and immigration activities – that are subject to other forms of legal regulation.
- c. Those who are not subject to any form of legal services regulation. These suppliers are sometimes referred to as 'unauthorised' or 'unregulated', but they are of course subject to various regulations (such as consumer protection legislation, data protection etc) which apply to all businesses in the economy.

Authorised legal providers are regulated by the SRA or one of the other seven approved legal regulators. The entities regulated by the SRA are diverse and range from small high street practices to large global law firms. A relatively new type of regulated entity, is known as an Alternative Business Structure (ABS) provider. Around 600 ABSs have been licensed,⁹ of which the SRA regulates around 439. These include traditional law firms who have non-lawyers on their boards, accountancy firms, insurance companies, local authorities and charities.

Some providers who deliver specific legal activities – such as immigration activities and claims management activities – are not regulated by one of the eight approved legal regulators. Rather these providers are regulated by specific bodies, such as the Office of the Immigration Commissioner (OISC) or the Claims Management Regulator (CMR).

Table 2 below shows the number of providers regulated by the different Approved Regulators and by the Chartered Accountants for England and Wales (for probate activities). As can be seen from this table, the SRA currently regulates over 92% of all regulated legal providers.

Table 2: Number of businesses regulated by different legal regulators

	Number of regulated businesses
Solicitors Regulation Authority	10,300
Council for Licensed Conveyancers	364
Intellectual Property Regulation Board	336
Bar Standards Board	39
CILEX	2
Institute of Chartered Accountants for England and Wales	150
Total regulated businesses	11,191

Source: Solicitors Regulation Authority (2016)

⁹ Competition and Markets Authority (2016).

Some firms who provide non reserved activities to the public are not regulated by any of the eight approved legal regulators, or by other bodies such as the OISC or the CMR.¹⁰ Accordingly, they are not bound by specific rules which apply to regulated legal providers, or to individuals who provide advice through those businesses. In short, such providers are not subject to any specific regulations over and above that which apply to all businesses, and their advisors are not required to have any particular qualifications.

A final type of ‘provider’ of legal services is solicitors who provide advice to a single client, such as in-house solicitors or solicitors who work for special bodies. The SRA estimates that around 18-20% of all solicitors (approximately 27,300) are in-house.¹¹ In-house solicitors are currently restricted in their ability to provide advice to parties other than their employer (although this restriction can be waived – see discussion below).

Regulated and ‘unregulated’ individuals

The number of regulated individuals who provide legal services is shown in table 3. This shows that solicitors are by far the greatest number of regulated individuals who provide legal services with some 133,000 practicing solicitors, representing over 82% of the total number of *regulated* individuals.

Table 3 below also provides an estimate of the number of individuals who provide legal advice in non reserved activities and are not regulated by one of the approved legal regulators or the OISC/CMR. Strikingly, the estimated number of such individuals in 2011 was in the vicinity of 130,000 individuals, which is broadly similar to the number of regulated solicitors (133,000).¹²

Table 3: Number of regulated and ‘unregulated’ individuals

	Number	% of total regulated and unauthorised individuals
Solicitors	133387	45.7%
Barristers	15716	5.4%
Legal Executives	6673	2.3%
Licensed Conveyancers	1200	0.4%
Costs lawyers	619	0.2%
Notaries*	1000	0.3%
Chartered Patent Attorneys*	2000	0.7%
Trade Mark Attorneys*	1500	0.5%
<i>Total regulated individuals</i>	<i>162095</i>	<i>55.5%</i>
Unregulated individuals*	130000	44.5%

* estimate only. Source: Solicitors Regulation Authority (2016) and Legal Services Board (2011).

¹⁰ Although the term ‘unregulated’ is used to refer to these businesses, such providers are not truly unregulated. They are still required to comply with legislation such as consumer law, data protection and Anti Money Laundering legislation.

¹¹ SRA (2016).

¹² Legal Services Board (2011).

Types of activities

For the purposes of analysis in this paper it is important to distinguish between two types of legal activities: reserved and non reserved activities. Only individuals and firms authorised by the SRA, or one of the other approved legal regulators, can deliver reserved activities to the public, or a section of the public.¹³ Table 4 below details the six reserved activities under the LSA 2007.

Table 4 also details a non-exhaustive list of commonly provided non reserved activities. The examples of non reserved activities are intended to be illustrative only and, in practice, by definition, any activity which is not a 'reserved activity' is a non reserved activity. The central point is that non reserved activities can be provided by persons who are not regulated by an approved regulator, and through an unauthorised business (see discussion above). A common example of a non reserved activity which can be provided through an unauthorised business is will-writing, which can be provided by any individual and through any form of business structure.

Table 4: Reserved and non reserved activities

Reserved activities	Examples of non reserved activities
Exercising rights of audience (the right to appear before a court)	General legal advice
Conducting litigation	Housing advice
Probate services	Employment advice
Reserved instrument activities (conveyancing)	Advice on planning disputes
Acting as a notary	Advice on funeral planning, including home ownership, probate matters
Administering oaths	Mediation services
	Will writing
	Advice provided by those with sector specialisation (such as paralegals)
	Document review and other unbundled service providers
	Online apps and information portal
	Advice provided by law centres, Citizens advice bureau and university legal services on a range of legal issues (such as housing, commercial, family, employment etc.)

¹³ However, not all of the approved regulators can provide authorisation for all of the reserved activities. Only the SRA, BSB and CILEX can authorise individuals to undertake all of the reserved activities apart from acting as a notary.

An important contextual point relevant to the changes being proposed is that, under the current regulatory framework, solicitors are only able to provide services – including non reserved activities – to the public, or a section of the public, if the business they operate through is authorised by one of the approved regulators. Accordingly, solicitors are not permitted to deliver non reserved activities to the public through unauthorised providers, even though non-solicitors may do so.

The consumers of legal services

The buyers of legal services are a heterogeneous group ranging from sophisticated, and repeat buyers of legal services (such as large companies and businesses) to consumers who only purchase legal services infrequently and have no prior experience of obtaining legal advice. This includes consumers who might be classified as ‘vulnerable’, which in this context, might mean that they are significantly impaired in their ability to choose or assess the value of legal services being offered because of their particular circumstances (see discussion in section 7 below).¹⁴ It follows that it is not possible to clearly characterise those who demand legal services, and studies have indicated that the demand for legal services tends to be impacted by factors such as income, age and education.

A general categorisation of the types of consumers of legal services might include: government purchasers, large businesses, small and medium sized enterprises (SMEs), charities, private individuals using their own funds, and individuals who are being funded by legal aid. An appreciation of the types of consumers of legal services is critical for the assessment of the market, and the need for different types of regulation. This is because, as in other market contexts, those consumers with more resources and experience of purchasing legal services are likely to be better able to negotiate services matched to their needs, and better understand any protections available to them in relation to the provision of the services, than consumers who have limited resources and only very infrequently purchase legal services.

3.2 Changes to the market

The above discussion has sketched out some of the key characteristics of the market. This section briefly describes some of the most important changes occurring in the legal services market in England and Wales that are expected to impact on the supply and demand for legal services in the future.

Increasing diversity in the range of regulated suppliers of legal services

The past decade has seen change in the types of legal advice providers, their business structures, and delivery mechanisms. The SRA has identified a number of important developments in the legal services market in recent years, many of which are tied to the development of ABSs.¹⁵ Although the number of providers registering as ABSs was initially relatively small, it has grown significantly in the past few years. The

¹⁴ See Legal Services Consumer Panel (2014a) for a discussion of consumer vulnerability in relation to legal services.

¹⁵ See Solicitors Regulation Authority (2016).

population of ABSs now encompasses a range of types of organisations, from small family-owned firms to very large corporate groups and major retail brands. The diversity in the types of organisations that are registered as ABSs is an indication of the fact that a range of different business strategies and models are being applied.

Some large legal brands are choosing to become ABSs, such as Irwin Mitchell that acquired multiple ABS licences for several businesses within its group. Well-known retail brands have also entered the legal services market as ABSs. Among them are the AA Law Ltd, BT Law Ltd, and the Cooperative Legal Services. Moreover, three of the Big 4 accounting firms have been authorised as ABSs, as has a local authority from Buckinghamshire. Each of these entrants are pursuing diverse business models and seeking to leverage their experience and expertise into the legal services market.

Another change is in terms of financing and operations of some authorised legal providers. In 2015, Gateley Plc was floated and shares became publicly traded on the AIM of the London Stock Exchange. Other law firms have obtained private equity financing in order to boost their capital reserves, and to grow their businesses. A particular group of entrants who is claimed to be altering the dynamics of the market are legal technology companies.¹⁶ Some of these companies use technology to offer high-volume, low margin, document review services.¹⁷

Growth in unauthorised providers and unauthorised individuals

While increased diversity can be observed in the types of regulated legal providers, there is also reported change in the unauthorised market. It is difficult to provide an estimate of the number of such unauthorised providers, however, the SRA has stated that there has been an 'exponential' rise in the delivery of non reserved legal activities to the public by providers who are not regulated by any of the legal services regulators.¹⁸ They include large professional services firms giving advice on employment matters, accounting firms providing advice on taxation or business structuring, small, single employee firms providing advice on different areas of compliance such as Health and Safety, and niche providers such as will-writing services. There are also technology companies providing non reserved activities using a combination of online automated services and paralegals (some of which also have arrangements to call on solicitors working in regulated entities on specific issues).

It is generally accepted that some solicitors are already facing direct competition from unauthorised providers and unauthorised individuals. A report by the Legal Services Consumer Panel (LSCP) predicted that, in the future, lawyers will be less involved in many of the tasks they have traditionally undertaken and that, in consumer and retail markets, consumers will seek out alternatives to lawyers, and will resort to self-lawyering, online services, and unauthorised providers.¹⁹ A recent survey of law firm leaders found that 83 per cent of those surveyed felt that competition from non-traditional service providers was a permanent change in the legal market.²⁰ The Law Society also observes that more solicitors, under the current regulations, might choose

¹⁶ See the discussion of legal process outsourcers and document assembly systems in Susskind and Susskind (2015).

¹⁷ See the Law Society (2016).

¹⁸ Solicitors Regulation Authority (2015a).

¹⁹ Legal Services Consumer Panel (2014b).

²⁰ Altman Weil (2015).

to relinquish official use of the solicitor title and establish themselves as a non-lawyer or unauthorised provider.²¹

Although it is not possible to obtain a precise estimate, it is suggested that regulated firms currently derive 53% of total turnover from non reserved activities. This has grown from around 46% of total turnover using 2014/15 data, suggesting that it is the non reserved activities that are experiencing growth. However, the growth in revenues associated with non reserved activities may not be evenly distributed among regulated and unauthorised providers of services. For example, the Law Society has observed that because employment advice is not a reserved activity, firms providing such services face competition from non-solicitor entrants and from accountants, banks and business consultants.²²

For some non reserved activities, such as advice on family, employment, personal injury, and intellectual property matters, some small and medium sized regulated solicitor firms are also facing competition from the Bar. This is particularly the case as it is no longer necessary for lay clients to instruct a solicitor before obtaining the services of a barrister.²³ In relation to family law, for example, barristers can offer the same services to consumers as family solicitors.

Changes in the types of organisations in which solicitors provide advice

Alongside the changes in the diversity of regulated providers, and the growth of unauthorised providers, another supply-side change that can be observed is where solicitors are choosing to practice law. Perhaps the most notable change here is the growth in the number of solicitors who are providing advice to a single client – i.e. in-house lawyers. Under current regulations, in-house solicitors cannot provide advice directly to the public (e.g. end consumers). Rather, in-house lawyers principally commission and manage external legal advisers, and work on behalf of their client on transactional legal work and other matters.

It is estimated that around one in five solicitors operate in-house.²⁴ The number of solicitors providing advice on this basis is said to have doubled in the period between 2000 and 2012. It is estimated that around 60% of solicitors who work in-house do so in the private sector, with many working in the financial services sector. Around 37% of in-house solicitors work in the public sector or for government, particularly for local government or for the Crown Prosecution Service. The remaining 3% work in the voluntary and charity sector, including advice centres.²⁵

The expectation is that the proportion of work undertaken by in-house solicitors will continue to grow. A recent survey of global corporate consumers found that just over half of them surveyed had increased the amount of legal work undertaken in-house.²⁶ The Law Society is of the view that in-house solicitors are no longer seen as a separate

²¹ The Law Society (2016).

²² The Law Society (2016).

²³ The Law Society (2016).

²⁴ SRA (2016). The Law Society (2016) suggests it is around one-quarter.

²⁵ The Law Society (2016).

²⁶ Allen & Overy (2014)

isolated team, but are ‘transforming’ how advice is provided to business.²⁷ They observe a growing number of specialists are leaving private practice to go in-house, and the expectation is that more solicitors from City firms and larger commercial firms will go in-house in the future.

Changes in how services are delivered: unbundling and outsourcing

The way in which legal services are provided to consumers is also expected to change in the future. There are three areas in particular where the supply and delivery of legal services is expected to change: unbundling of legal services; increased outsourcing; and the use of paralegals.

In general terms, unbundling refers to a situation where consumers and legal providers agree to share the tasks associated with a legal activity between them. Typically a consumer might choose to purchase legal advice at key stages, and combine this with work they do themselves. The main areas of law where unbundling occurs include employment, probate and immigration matters. It is estimated that around one-fifth of all transactions now involve unbundled legal services,²⁸ and the expectation is that there will continue to be a movement towards the ‘unbundled’ provision of some legal services.²⁹ The Law Society expects that an increasing number of in-house lawyers will opt for unbundled legal services in the future, whereby they run their own cases but purchase expert assistance at key stages of a matter.³⁰

The growth of unbundling, in part, appears to reflect changes in consumer preferences and, in particular, a desire among some consumers to have greater control over their legal matter, while also offering a more affordable means of accessing legal advice.³¹ In this respect, unbundling expands access to legal services – allowing consumers to obtain advice in circumstances where they may have not been prepared to obtain a full legal service. A 2014 survey by the Legal Services Consumer Panel also found that consumers generally had a positive experience of unbundling, with respondents noting only a small difference in service satisfaction between unbundled and full service legal services.³²

Another supply-side development is the further expansion of the outsourcing of legal activities. Generally this involves the outsourcing of high volume, repetitive and low risk tasks – which might typically be work undertaken by junior staff in traditional law firms – to third parties. Research in 2012 estimated the size of the global outsourcing market at £2.4 billion.³³ However, it is suggested that the scope of activities that can be outsourced is growing even further as the market matures and expands. The growth of outsourcing appears to be driven, in part, by a desire to reduce costs.

Another area where changes are being observed in terms of how legal services are

²⁷ The Law Society (2016).

²⁸ Legal Services Consumer Panel (2014c).

²⁹ See Solicitors Regulation Authority (2016) and The Law Society (2016).

³⁰ The Law Society (2016).

³¹ Solicitors Regulation Authority (2016).

³² Legal Services Consumer Panel (2014c).

³³ Lacity and Willcocks (2012)

delivered is in terms of staffing of law firms, including the use of paralegals and contract lawyers. The use of paralegals as an alternative to fully qualified solicitors continues to grow and some estimates suggest that paralegals now make up around 44% of all fee earners in solicitors firms.³⁴ There is also an increasing use of contract lawyers, who are employed by law firms or other organisations for a specific period of time or task. One survey suggests that up to 70% of UK corporate consumers of legal services had used contract lawyers in the past couple of years.³⁵

A further change in how legal services are being delivered is the growth in online legal advice services. This type of delivery mechanism is prominent in areas such as will-writing and divorce advice, but some expect that it will be expanded into other areas of law. Some business surveys suggest that the market penetration of online legal services will rise from 28% to 37% in the next five years.³⁶ In part, this reflects the fact that consumers are increasingly interested in the lower cost and increased convenience of services provided online.³⁷

Finally, some consumers are using increased access to information online to 'self-supply' and seek to address and resolve legal problems themselves (sometimes referred to colloquially as 'DIY law'). One recent survey found that there was a 30% increase in family court cases whether neither side had legal representation.³⁸ The Legal Services Consumer Panel has suggested that, in the future, consumers will seek to rely on more self-lawyering and online services, as well as services provided by accountants and banks.³⁹ While access to technology has increased the amount of self-lawyering, the Law Society has recently indicated that a full decamping of general public consumers to self-lawyering is unlikely.⁴⁰ This is because, in their view, very few savvy clients will have the time or the expertise to be comfortable being their own lawyer. However, there are contrasting views on the impacts that technological change will have on the legal profession, with some commentators suggesting that in the future traditional lawyers will in large part be replaced by advanced systems, lay people with online self-help tools, or cheaper labour assisted by technology.⁴¹

Changes to charging arrangements

Changes are also being observed in how providers are charging for legal services. In particular, the traditional model based on hourly charging is being replaced by the increasing use of fixed fees for services. Estimates suggest that around 46% of all legal transactions in 2014 were based on a fixed fee arrangement. Fixed fee charging arrangements are particularly prevalent in the area of consumer law, including will writing, conveyancing, power of attorney, immigration and family law services. In

³⁴ See Law Careers (2015).

³⁵ Allen & Overy (2014).

³⁶ Allen & Overy (2014).

³⁷ The IRN Research (2015) survey of 500 adults in December 2014 found that 40% would be attracted by the convenience and low cost of online legal services.

³⁸ House of Commons (2016).

³⁹ Legal Services Consumer Panel (2014b).

⁴⁰ The Law Society (2016).

⁴¹ See Susskind and Susskind (2015) and Susskind (2008).

contrast, charging arrangements based on hourly rates, are most common in the areas of probate and employment law.⁴²

Affordability and unmet demand for legal services

Notwithstanding the broadening in types of suppliers, and changes to delivery methods, of recent years, there is still a widely held view that there exists substantial unmet demand for legal services. The Competition and Markets Authority (CMA), for example, has noted perceptions of unmet demand in the sector, which they define as where consumers have a legal need but do not seek to purchase legal services.⁴³

Research commissioned by the SRA indicates that just under half (49%) of the adult population in England and Wales had a 'legal need' over the past three years,⁴⁴ and yet it is estimated that fewer than one in ten people experiencing legal problems instructed a solicitor or barrister.⁴⁵ A 2015 survey found that 10 percent of adults considered paying for legal advice, before changing their minds.⁴⁶ Among the reasons given for changing their mind were: lack of affordability; it seemed complicated; and, having received some initial free advice, they decided not to pay for further advice.

Although there are various reasons why an individual may not chose to access legal services, the perception that professional legal services are unaffordable seems to be a critical contributing factor.⁴⁷ As discussed below, one survey found that 63% of those surveyed did not believe that professional legal advice was affordable for 'ordinary people'.⁴⁸ Another survey found that 21% of adults arranged their own divorce because they could not afford a solicitor.⁴⁹ The Law Society has recognised that there is a large group of potential clients that cannot afford to pay for legal services.⁵⁰ Moreover, they expect this situation to get worse over the next five years.

Research also suggests that small business may have unmet demand for legal services, and that the majority of business have limited contact with legal providers. A study commissioned by the Legal Services Board found that around half of small business that had experienced a legal problem attempted to resolve it on their own, and that they often sought the advice of other professionals such as accountants rather than lawyers.⁵¹ The same study found that only 13% of small business regarded lawyers as cost effective.

⁴² See Legal Services Consumer Panel (2014c).

⁴³ See Competition and Markets Authority (2016).

⁴⁴ See BDRG Continental (2012). The most common areas where legal need arise are consumer problems (29%); debt and money problems (27%); conveyancing (26%); will writing (23%) and probate (19%).

⁴⁵ Solicitors Regulation Authority (2016).

⁴⁶ YouGov (2015).

⁴⁷ The Competition and Markets Authority (2016) refers to concerns around the affordability of legal services. YouGov (2015) survey noted that the cost of services as mentioned by more adults (75 per cent) than anything else as being a factor when choosing a legal adviser.

⁴⁸ Hodge, Jones and Allen (2015).

⁴⁹ YouGov, (2013).

⁵⁰ The Law Society (2016).

⁵¹ See Blackburn, Kitching and Sari (2015).

Consumer satisfaction and levels of engagement

Allied to the previous point, some concerns have been expressed about the service standards of regulated and unauthorised providers.⁵² The SRA has referred to research which shows that the perceptions of service quality differ between service providers and consumers, and that lawyer perceptions of the quality of service are often higher than that of consumers.⁵³ Among the main areas where complaints are received are in relation to poor communication and a lack of clarity around pricing. Of relevance to the proposals being considered by the SRA is the finding that complaints about non reserved legal activities are one-seventh of the number of complaints about reserved activities.⁵⁴

There are also concerns that consumers of legal services remain insufficiently engaged in the market, and are not active in seeking out alternative providers. In large part this may reflect the difficulties consumers face in terms of differentiating among providers, and in particular in assessing differences in the quality of providers. A 2015 survey found that 60% of consumers agreed/strongly agreed that they are unable to differentiate one high street law firm or solicitor from another.⁵⁵ The Law Society recently observed that there *'remains a great deal of uncertainty amongst consumers about different types of lawyer and legal businesses. It is currently very difficult, even for knowledgeable consumers, to work out which provider is the most appropriate for their particular issue; and on the Internet, most firms look the same'*.⁵⁶ However, other research suggests that for more severe problems consumers are able to channel towards advice and formal processes, including independent help and law firms.⁵⁷

According to work undertaken by the SRA, the main method by which most people identify a solicitor is via referral, and locality appears to be a particularly important factor in determining which provider to choose. Research suggests that other active methods for increasing consumer engagement – such as the use of comparison websites – are used relatively infrequently.⁵⁸

Given the nature of some legal services – for example, a consumer can only choose among specific providers in legal aid matters – the role of the consumer in actively choosing a service provider can be more limited than it might be in other markets. However, some commentators are suggesting that consumers are becoming more active, and that this is being facilitated by technological changes that allow them to search and compare different provider options. Moreover, it has been suggested that

⁵² See for example, Competition and Markets Authority (2016).

⁵³ See Solicitors Regulation Authority (2016).

⁵⁴ Analysis by the SRA notes that of the 12,445 regulatory reports received between September 2013 and August 2014, 59% related to work that was a reserved activity and 8% related to a non reserved activity.

⁵⁵ YouGov (2015).

⁵⁶ The Law Society (2016).

⁵⁷ See Pleasence and Balmer (2014).

⁵⁸ Legal Services Consumer Panel (2014c).

consumers have increasingly been demanding changes to charging arrangements (such as fixed fee arrangements as described above) and lower fees.

Innovation and technological change

Innovation and technological changes are having significant impacts on both the supply of, and demand for, legal services. On the supply side, research conducted by the SRA/LSB on innovation suggests that some legal services firms are innovating in ways that extend their service range, improve quality and attract new clients.⁵⁹ The same study found that solicitors are more innovative than other regulated legal services organisations in terms of both managerial and organisational changes. However, they are less innovative than unauthorised providers.⁶⁰ A noteworthy finding is that ABSs are particularly innovative. ABSs are 13-15% more likely to introduce new legal services than other law firms. As the SRA has observed, this is not especially surprising as new investments in ABSs typically included investments in technology and changes in how services are delivered.⁶¹

Technological change is widely considered to be having a significant impact on how legal activities are conducted, and how services are delivered to consumers. Many legal businesses are introducing technologies to improve their processes and to grow their businesses, and it is expected that some legal providers will continue to invest in information technology. The Law Society has noted that among the ways in which changes in technology are impacting on legal services include: increasing use of software programmes to read contracts and other legal documents; improvements in the efficiency with which providers deliver procedural and commodity work; and new assistance to consumers with decision-making and purchasing behaviours.⁶² Technology-based providers, such as Axiom and Rocket Lawyer, have entered the market to provide tech-enabled legal services to consumers. Axiom supplies contract services; regulatory and compliance services; corporate transactions and insourcing. Rocket Lawyer provides advice on family and personal matters, as well as business, property and employment advice. More generally, legal 'exchanges' are emerging that can allow for online auctions of legal tasks.

As in other economic sectors, the long-term impact of technological change is difficult to assess. Some commentators see a limit to the extent of automation of routine work, noting that the main changes will be seen in service delivery methods.⁶³ Others foresee potentially significant disruptive effects if the developments in Artificial Intelligence, such as IBM's cognitive computer ROSS, are further refined and become widespread in application.⁶⁴

⁵⁹ Roper, Love, Rieger and Bourke (2015).

⁶⁰ Roper, Love, Rieger and Bourke (2015).

⁶¹ Solicitors Regulation Authority (2014a).

⁶² The Law Society (2016).

⁶³ See the Law Society (2016) who predict that: "*The push towards automation of routine work will be levelling off by 2020, and instead we might expect to see technology fuelling innovative models of delivery or service solutions.*"

⁶⁴ Generally, see Susskind and Susskind (2015), and Susskind (2008) for a discussion of these trends.

Technological change is also having major impacts on consumer behaviour. As already noted there has been a steady rise in the growth of online legal services. Like in other market and social contexts, some consumers are increasingly using the Internet to research different options for legal advice, and to research information on specific legal problems. The Law Society has noted that changes in how some consumers communicate, and interact, with legal providers via screen technologies is consistent with wider changes in expectations of many consumers about how legal services should be provided.⁶⁵ This is expected to benefit legal providers who are able to accommodate these changes in expectations, such as large consumer and household brands that are already familiar with interacting with consumers online.

3.3 Regulatory and policy context

As noted in Section 1, regulation can be either a facilitator or inhibitor in times of change, and a central challenge for regulators and policy makers is to design a set of regulations which facilitate positive market changes, while ensuring that other public policy objectives are fulfilled (such as consumer protection, access to justice etc.).

Changes to other laws which impact on legal service regulation

There have been a number of changes to the laws and regulations which apply to all businesses and service providers in the economy, and which impact on the need for specific regulations in relation to legal services. Among the most important of these are developments in consumer and competition laws, which are generally applicable. For example, the Consumer Rights Act 2015 imposes certain requirements in relation to all service contracts with consumers in relation to service quality, timing and price. Changes to money laundering and data protection laws have also made these laws more generally applicable to businesses and service providers across a range of economic sectors, including legal services.

Developments in legal regulation and the need for further regulatory reform

As discussed in section 2, there has been number of changes to the regulation of solicitors since the introduction of the Legal Services Act 2007. Among the most significant of these: the shift toward an outcomes focussed approach to regulation (“OFR”) and the gradual removal of detailed prescription; the introduction of licensing for ABSs; and the introduction of multi-disciplinary partnerships. However, as noted above, the SRA is of the view that further regulatory reform is required, particularly as the majority of regulatory arrangements currently in place pre-date the introduction of the LSA.

At a more general level, there have been calls – including by legal services regulators – for more significant and radical change to the institutional framework for the

⁶⁵ The Law Society (2016).

regulation of the legal services sector.⁶⁶ In responses to the 2013 Ministry of Justice (MoJ) Legal Services Review, there was an apparent consensus among the different legal regulatory bodies that reforms had not worked out as anticipated. The Legal Services Board was critical of the new arrangements, particularly what it considered to be a general resistance to the market liberalisation initiatives that have been introduced, which were seen as adding costs, rather than removing burdens.⁶⁷

The two largest approved regulatory bodies – the SRA and the Bar Standards Board (BSB) – were also critical of the regulatory framework in their submissions to the review.⁶⁸ The SRA submitted that the '*regulatory settlement provided by the LSA [Legal Services Act 2007] remains imperfect*', however, in its view, and despite significant flaws, the new regulatory system functioned better than the arrangements prior to 2007.⁶⁹ The Law Society also identified a number of problems with the new regulatory arrangements.⁷⁰

The CMA Market Study

In part because of the concerns described above, the Competition and Markets Authority (CMA) recently launched a Market Study into the supply of legal services in England and Wales under the Enterprise Act 2002. The CMA has observed that responses to the 2013 MoJ review have advocated markedly different views on the reform of the current regulatory framework; some parties advocating a return to the pre-2007 framework, others arguing that the 2007 reforms had not gone far enough and that further changes were needed.

In its Statement of Scope, the CMA has set out three themes that it is seeking to explore. The first focuses on information, and in particular, whether consumers can 'access, assess and act' on information in ways which allow them to make informed decisions. The second theme focuses on regulation, and specifically whether the existing regulations and/or redress mechanisms are adequately dealing with consumer protection issues that arise because of information failures. The third theme involves examining whether regulations and the regulatory framework may be disproportionate, and in excess of what is necessary, and may, in fact, be contributing to a weakening of competition or distortion in the supply of legal services.

Government reviews

Alongside the CMA Market Study into the supply of legal services, there have been reports that there will be a review by the MoJ of the LSA 2007 and the wider regulatory

⁶⁶ See in this context the paper published by the Legal Services Board (2015) that draws together cross-regulator views on, among other things, options for the shape of the regulatory architecture.

⁶⁷ See Legal Services Board (2013).

⁶⁸ See Bar Standards Board (2013).

⁶⁹ See Solicitors Regulation Authority (2013).

⁷⁰ See The Law Society (2013).

framework. In addition, the government has said that the Treasury will consult, in spring 2016, on removing barriers to entry for ABSs in legal services, and on whether to make the approved legal regulators independent from their representative bodies.

4. General considerations to frame the analysis

This section sets out some general considerations that are important to frame the assessment of the specific changes that are being proposed. It briefly considers foundational issues such as: Why do we regulate legal services? What is the balance between consumer protection laws and competition? How do we regulate legal services and what are the merits of alternative regulatory approaches to achieving a set of objectives?

4.1 Why regulate legal services?

A central issue that confronts all regulators in practice is why the particular activity they oversee is subject to regulation.⁷¹ In some areas of economic regulation, such as for the monopolistic parts of the utility industries, the rationale for regulation is widely understood and generally related to the demand and cost characteristics of that activity. However, in other areas of economic activity, particularly where there are a number of suppliers, the argument for specialist economic regulation is generally more idiosyncratic, and tends to be associated with specific concerns about the concentration of supply structures (including barriers to entry) or issues associated with a significant information and power asymmetry between suppliers and consumers which have market-wide effects.

Understanding the rationale for economic regulation in these (non-utility) contexts is particularly important given the existence of generally applicable consumer protection laws and competition laws, which are directed at protecting consumers, and ensuring that competition in different markets is effective and works well for consumers. In the context of legal services, the economic arguments for some form of specialist regulation, over and above standard competition/consumer law, are generally made with reference to certain characteristics of the demand side and the supply side of the market, as well as wider considerations about the role of legal services in reducing transactions costs.⁷²

Characteristics of the demand side of legal services

On the demand side, the most common economic rationale for some form of oversight of legal services relates to issues regarding 'quality of service' (in a broad sense), and, in particular, to issues associated with information asymmetries between suppliers and consumers, which can affect the ability of consumers to assess quality.⁷³

However, three remarks can be made about this rationale for regulation of legal services. First, information asymmetry between providers and consumers is not unique

⁷¹ This section ignores questions of how legal services should be regulated - such as professional self-regulation; co-regulation, statutorily independent or public regulation.

⁷² For a more detailed discussion of some of these economic rationales see Decker and Yarrow (2010).

⁷³ See Competition and Markets Authority (2016).

to legal services; it occurs in many types of professional services, and in relation to many other services and products.⁷⁴ In many of these other settings, a *market* (as opposed to regulatory) response to the potential problem of information asymmetry emerges through the development/mechanism of reputation (and, in many cases, self-regulation through professional associations or standards). In this respect, suppliers in a particular industry or sector can have a *collective* interest in ensuring that the sector has a reputation for quality as this can increase demand for the services and expand the size of the market.⁷⁵ In short, specialist regulation is not the only mechanism for incentivising quality where there is an information asymmetry between suppliers and consumers.

Second, an asymmetry in the quantity and quality of information available to sellers and consumers can result in the 'over-provision' of particular services in some circumstances,⁷⁶ but to the 'under-provision' of services in others.⁷⁷ That is, it should not always be assumed that an information asymmetry always results in the over provision of services. In the case of legal services, for example, it might be argued that the information asymmetry is in part responsible for the levels of unmet demand as consumers avoid the market for fears of being exploited, or of not understanding the service.

Third, regulation to address information asymmetry sometimes focuses on providing greater amounts of information to consumers to enable them to make more considered and informed choices. However, as research in behavioural economics has shown, there may be diminishing returns (from a consumer's point of view) in information provision, particularly in more complex or technical areas. Rather than empowering consumers, too much, or poorly targeted, information can increase consumer confusion rather than reducing information asymmetry.

Characteristics of the supply side of legal services

On the supply side, the arguments for the specialist regulation of legal services, and the legal profession in particular, principally derive from the way in which legal professionals have historically organised themselves, and the various rules, restrictions, customs and practices that have been adopted, which can potentially affect the supply of legal services. Here too some brief remarks are merited.

⁷⁴ Other examples of services (so-called credence goods) where there is a significant information asymmetry include the services provided by: optometrists, computer engineers, car mechanics and taxi-drivers. See Dulleck and Kerschbamer (2006) on the economics of credence goods.

⁷⁵ Organizations sometimes seek to maintain high quality service provision across an industry or sector by a process known as 'delegated exclusion'. This refers to situations in which particular suppliers can be excluded from the market by virtue of the existence of authorisations or licensing arrangements which allow for the "striking off" of suppliers who do not perform at an appropriate standard. See Tirole (1996).

⁷⁶ For example, where consumers are unable to determine whether a service has been provided unnecessarily.

⁷⁷ For example because consumers recognise the risks associated with being unable to distinguish between the quality of different service providers, and avoid these risks through avoidance of the market (i.e. consumers are deterred from obtaining relevant legal services).

One of the traditional roles of self-regulating professional associations is typically to introduce various rules, norms and standards relating to: entry into the profession; acceptable conduct for those within the profession; and acceptable business structures. From an economic point of view, the key question is what impact these rules and restrictions can have on economic welfare. Some rules and restrictions can be beneficial to economic welfare, by increasing the collective level of quality, and removing unethical or poorly skilled practitioners. This can increase consumer confidence and expand the market. However, some rules and restrictions can have adverse effects on economic welfare. For example, unnecessary restrictions on entry or organisational form can limit competition and innovation.

The key empirical question is: which rules/restrictions/practices increase quality in the supply of legal services and therefore consumer confidence, and are potentially market expansionary, and which rules/restrictions/practices are unnecessary or disproportionate and increase costs, raise prices, limit consumer choice and innovation? In this context, there may be a role for a specialist regulatory framework, and regulatory body, to scrutinise and examine specific rules and restrictions and consider how these affect the supply of legal services, and therefore economic welfare.

The link between well-functioning legal systems and economic performance

A wider economic rationale for some form of specialist regulation of legal services derives from the role of legal services in an economy and society, and particularly in terms of reducing transactions costs and facilitating trade and exchange. A substantial body of economic analysis and evidence suggests that well-functioning institutions (of which formal legal systems are a key component) contribute to, and facilitate, economic development and performance and social development.⁷⁸ A 'well-functioning' legal system is conceived as one that is stable and provides certainty to market participants at reasonable cost, allowing them to transact in confidence, while being sufficiently adaptable to new and evolving circumstances. In short, it could be argued that because the core activity of the legal services sector tends to expand market activity throughout the economy, it is closely linked to economic performance and growth and social development.⁷⁹ This is a feature that distinguishes legal services from a number of other professional service activities with which they are often compared in economic and policy assessments, and which may justify some degree of specialist oversight.

In sum, there is a need, in assessing the SRA's proposed changes, to consider how they relate to the various rationales for legal services regulation. If the proposed changes open up supply options, and allow for greater diversity in business models and practices, this could have implications for the on-going relevance of the specialist regulation of legal services where this is premised on the supply side characteristics

⁷⁸ Prominent examples include the work of: North (1981); North (1990); North and Thomas (1973); Acemoglu, Johnson and Robinson (2005); Acemoglu and Robinson (2012); Beck (2012).

⁷⁹ This rationale arguably underlies many of the 'Rule of Law' projects undertaken by bodies such as the World Bank in emerging and developing economies.

as described above. Similarly, if new delivery methods and innovative ways of addressing consumer needs are developed as a result of the changes, this can have implications for the relevance of such aspects of legal services regulation as are premised on the risks of information asymmetry. The central point is that, as in other areas of economic regulation, changes in a market – including those induced by regulatory change – can sometimes call into question the continuing rationale for regulation, or its existing architecture.

4.2 Balancing competition and consumer protection regulation

Economists would generally argue that robust competition is the best form of protection for consumers, and that in most markets only minimal consumer protection regulations are warranted (relating to fraud or deception, faulty services, non-performance of contractual commitments, or enhanced market transparency).⁸⁰ This is because, in effectively competitive markets, suppliers have a natural incentive to foster a reputation for being reliable and good quality,⁸¹ and can have incentives to overcome information asymmetries where they exist.⁸²

However, it is also recognised that in some competitive market contexts, competition alone may not adequately protect consumers and ensure that they make effective choices. These market contexts might be categorized as those where there is a lack of incentive to maintain a good reputation and those where there are pronounced information asymmetries between suppliers and consumers. As discussed above, one of the main arguments made for some form of specialist regulation of legal services – over and above that provided by generic consumer protection and competition laws – is the need to protect consumers in a context of asymmetric information. This argument is generally made with reference to the fact that the services tend to be of high importance and there are limited mechanisms for consumers to compare the quality of service offerings.

In most areas, regulations directed at protecting consumers, and initiatives directed at promoting competition, are mutually reinforcing. For example, consumer regulations which require information to be presented in specific ways so it is understandable to consumers can reduce information asymmetries and enhance the ability of consumers to compare offerings and make informed decisions, thus increasing competitive pressures on suppliers. Similarly, initiatives directed at promoting competition can foster markets where suppliers compete on their merits, and have incentives to supply consumers with products and services that best satisfy their preferences.

⁸⁰ See, for example, Armstrong (2008); Armstrong (2011); Muris (2002).

⁸¹ As Muris (2002) puts it: *“The consumers’ ability to shift expenditures imposes a rigorous discipline on each seller to satisfy consumer preferences. It often motivates sellers to provide truthful, useful information about their products and drives them to fulfill promises concerning price, quality, and other terms of sale. Consumers can punish a seller’s deceit or its renegeing on promises made by voting with their feet – and their pocketbooks.”*

⁸² For example, in order to build market share firms may seek to reduce the search and switching costs of consumers by reducing some of the costs of switching (i.e.: carrying the burden of any one-off costs of switching) or providing targeted information which allows consumers to better understand the offer available.

However, there can also be areas of tension between consumer protection regulations and initiatives directed at promoting competition. This is because additional consumer protection regulations, over and above that provided in generic consumer law, can impact on supplier (supply side) and consumer (demand side) behaviour, and therefore on competition and innovation, and ultimately, on consumers.

Impacts on the supply side

Specialist consumer protection regulation, over and above general consumer law, can impact directly and indirectly on the behaviour and incentives of suppliers in a market, and therefore on competition. Most obviously, additional consumer protection regulations can impose direct costs on suppliers, which are ordinarily reflected in prices paid by consumers.⁸³ These costs manifest in various ways but might include costs associated with requirements to: provide minimum levels of quality,⁸⁴ or to participate in specialist consumer dispute resolution schemes (such as an Ombudsman scheme). To the extent to which these requirements are placed on all suppliers, both traditional and alternative (non-traditional), this can reduce incentives for entry into a market and may place a disproportionate burden on smaller businesses (given their limited staff and resources and lower customer base over which to spread costs).

Specialist consumer protection regulation can also impact directly on the supply side of the market by restricting the ability of suppliers to advertise and market their products, or, where there are licensing conditions for entry into a market, by discouraging innovation in supply methods.⁸⁵ Policies that constrain entry are frequently premised on the need to protect current consumers, but undue restrictions on entry may impact on the development of competition and therefore the protection of future consumers.⁸⁶

Impacts on demand side

While specialist consumer protection regulation, over and above general consumer law, can in some circumstances help address an information asymmetry between

⁸³ However, this does not mean such costs are borne equally by all consumers. This was recognized in an early UK legal case touching on consumer protection where it was observed that: “*the price to the public of the protection afforded to a minority of consumers might well be an increase in the cost of goods and services to consumers generally.*” See *Tesco Supermarkets Ltd v Natrass* (1971).

⁸⁴ One way of conceptualizing regulations imposing minimum quality standards is that they are effectively a prohibition on the ability of customer’s to purchase lower-cost, but lower quality, goods and services.

⁸⁵ As Armstrong (2008) observes: “*Although its aims may be honorable, there is a long history of consumer protection being used as an excuse for industry protection, which is a form protection that consumers do not want.*”

⁸⁶ Vickers (2003) and Armstrong (2008) both refer to an example of a consumer policy which requires that all airlines offer a full meal service on flights. Such a policy inadvertently bundles the flight and the full meal, limiting the choice of consumers who would prefer not to pay for a full meal. At the same time it can discourage entry by budget airlines who seek to offer an alternative service, and reflect that in the price.

consumers and suppliers by assisting consumers to make better and more informed choices, there is a potential ‘moral hazard’ associated with this approach.⁸⁷ In short over-protected consumers may not invest effort to ensure that they acquire the skills to make effective decisions in the market.⁸⁸

Other aspects of specialist consumer protection regulation can impact on consumer choice and soften competition, including restrictions on the ability of suppliers to contact consumers, and restrictions on comparative advertising. While each may have valid justification along some dimension of potential consumer harm and dis-amenity, they can also have negative effects along another dimension by, for example, reducing the information available to consumers,⁸⁹ increasing consumer search costs,⁹⁰ crowding out market solutions to particular problems,⁹¹ and preventing price discrimination by firms where this may be pro-competitive.

In a number of sectors – such as the utility sectors – specialist consumer protection regulations have been introduced with the specific aim of protecting certain groups of consumers (such as vulnerable consumers). While these policies are often motivated by fairness or social welfare considerations, there is also an important economic dimension to such policies: if a significant proportion of consumers are, for various reasons, inactive in a market, then active consumers need to work harder to ensure that competition is effective.⁹² Nevertheless, the extent to which informed and uninformed consumers⁹³ protect, or even harm, one another is a growing area of research in economics. In brief, this work finds that the effects of consumer protection policies can vary across economic settings, and that in some contexts consumer protection regulations designed to protect uninformed consumers can actually harm informed consumers.⁹⁴ In particular, such policies may have the unintended consequence of undermining the rewards that certain consumers obtain from being active in the market and expending the time and effort to gather and process

⁸⁷ See Armstrong (2008).

⁸⁸ Armstrong (2011).

⁸⁹ Examples are restrictions on the ability of firms to contact consumers (such as cold calling), which can result in a smaller proportion of consumers being informed about offers in a market thus softening competition in the market. Similarly, restrictions on comparative advertising can limit the ability of suppliers to point out the superior attributes of their products and services relative to rivals.

⁹⁰ For example, the benefit of restricting commission payments to intermediaries depends on how the reduction in average prices from taking away such payments compares to any increase in consumer search costs associated with the removal of brokers.

⁹¹ For example, firms may have incentives to introduce measures that address the cognitive limitations, or relative inattention, of consumers. An oft-cited illustration is that firms may have incentives to overcome the consumer confusion about product offerings (sometimes referred to colloquially as ‘confusopoly’) by offering a simple product and pricing proposition.

⁹² As Armstrong (2014) puts it: “*An old intuition in economics suggests that savvy consumers help to protect other consumers, and that consumer policies which protect vulnerable consumers are only needed when there are insufficient numbers of savvy types present in the market.*”

⁹³ Sometimes also referred to as sophisticated or naïve consumers, or active and inactive consumers.

⁹⁴ See Armstrong (2008) and references therein.

information about alternative offers.⁹⁵ Such policies can also potentially have adverse impacts on all consumers.⁹⁶

The key point is that the appropriate balance between specialist consumer protection regulation and initiatives directed at promoting competition can be a fine one. Achieving such a balance is seen of particular importance in economic contexts undergoing significant economic change, and where established and traditional supply methods are being disrupted by new entry and supply arrangements. For example, the emergence of ‘sharing economy’ platforms in some parts of the economy (such as Uber, Airbnb etc) has led to recognition of a need to tailor regulation so as to not be disproportionate and discourage innovation and entry. Similarly, the emergence of so-called ‘non-traditional business models’ in electricity have prompted some regulators to consider whether new approaches to regulation, particularly consumer protection, are required. For example, it has been argued that regulatory arrangements should recognise that some consumers are willing to accept a greater risk of disruption, or higher prices, by actively participating in community energy schemes – i.e. consumers are willing to trade off some traditional protections where they perceive other benefits from doing so. In short, regulators and policymakers across a range of markets experiencing change are recognising a need to tailor regulation to ensure an adequate degree of consumer protection, while also not impeding innovation and the development of different supply methods.

4.3 Choice of regulatory strategy: outcomes v prescriptive rules

The preceding discussions in this section have focussed on why we regulate legal services, and why there may be a need for a specialist consumer protection over and above general consumer protection law. A separate relevant framing consideration is how best to regulate such services to achieve a particular set of policy objectives.

Regulators can deploy different regulatory strategies to achieve policy objectives. One general strategy, often referred to as a rules-based regulatory approach, typically involves the development of detailed *ex ante* rules that are highly particularistic and prescriptive and give suppliers advance notice as to what actions they can and cannot engage in. Such an approach typically provides limited flexibility in any specific factual context. Another regulatory strategy, often referred to as a principles-based (or outcomes-focussed) regulatory approach, typically involves the regulator specifying outcomes or principles, cast at a high level, which allows regulatees some discretion

⁹⁵ As Armstrong (2008) puts it in relation to policies which restrict choice in the market on this basis: “Such policies are usually highly re-distributive between consumer groups, and often have the flavour of putting fences alongside cliff-top paths: they protect careless or vulnerable walkers from falling off, but they reduce the utility of everyone else”.

⁹⁶ An oft cited example was the introduction by the British energy regulator (Ofgem) of non-discrimination clauses in suppliers licences, which limited the ability of companies to offer discounts in different parts of the country. This policy was premised, in part, on concerns about vulnerable consumers being less active and having lower levels of switching. Assessments of this policy have suggested that all consumers, including vulnerable consumers, faced higher prices after the policy was introduced. See Waddams-Price and Zhu (2013) and Competition and Markets Authority (2015b).

as to how best comply with these principles/outcomes. In this regard, regulatees are required to exercise judgement to predict what actions will achieve the regulatory objective.

The current approach adopted by the SRA is outcomes-focused (outcomes-focussed regulation, or OFR). However, as discussed above, and based on its experience since its initial adoption of the approach, the SRA considers certain elements of the approach need to be further refined and developed. In particular, the SRA is concerned that, as currently implemented, there remains too much detailed regulatory prescription, and that the distinction between binding principles and non-binding guidance is unclear to some regulatees. It therefore considers that the current implementation is not achieving the full advantages of the approach.

A key perceived attribute of OFR is that, by shifting the focus away from the detail of individual prescriptive rules (which seek, in combination, to achieve a regulatory outcome) to the regulatory goal or outcome itself, regulatees should be encouraged to think more carefully about the ultimate objective and how best to achieve it. This, it is argued, should avoid mechanistic adherence to (or technical avoidance of) regulatory rules.⁹⁷ In addition, the approach is seen as more durable than detailed prescription because high level principles and open-textured provisions can capture a wide range of behaviours, and avoid large enforcement or compliance gaps emerging where market conditions change and new risks emerge. This is seen as particularly important in sectors, such as legal services, where significant market change is occurring (such as through the emergence of new supply methods or rapid technological change).⁹⁸

The main risk with OFR stems from the potential for imprecision and vagueness, which can leave regulatees uncertain as to how to comply with a required regulatory outcome. In some contexts, this can have a chilling effect on behaviour and foster a degree of conservatism among regulatees, and stifle what may be desirable behaviours.⁹⁹ This risk can potentially be mitigated through the publication of non-binding guidance or indicative actions and behaviours that illustrate or exemplify compliance with a goal. However, if a regulator overuses this mechanism such that regulatees are confronted with a proliferation of guidance, or if regulatees treat such guidance as prescriptive rather than exemplary, this will create similar issues to those that arise under a prescriptively detailed rules based approach.¹⁰⁰ One of the SRA's concerns underlying its proposed changes to the Handbook is that regulatees are treating the non-binding indicative behaviours in the Handbook as prescriptive, which may be undermining some of the potential benefits of the OFR approach. A related risk is that such regulatees feel compelled to seek out expert advice as to what actions are in accordance with regulatory goals. This can foster the development of a 'compliance industry' that may have incentives to lead regulatees to engage in risk reduction activities at costs that are significantly disproportionate to potential

⁹⁷ In short, OFR can change the mindset of regulatees by requiring them to 'think through' the consequences of their actions and how they correspond to a particular regulatory outcome.

⁹⁸ Mumford: (2011) describes the general approach as a '*policy experiment to facilitate technological innovation.*'

⁹⁹ See Cunningham (2007) on this point.

¹⁰⁰ See Black (2008) on proliferation of guidance in financial services regulation.

benefits¹⁰¹ i.e. this can lead to 'over-compliance'. It follows that the extent to which regulatory arrangements guide regulatees in relation to the practical detail of their obligations, without fully prescribing these, will be important in any implementation. Finally, smaller firms may face disproportionate costs in having to assess how to comply with their regulatory requirements.¹⁰² Again, mitigation of this risk can only occur through the specifics of implementation.

The key point is, because the potential range and extent of risks associated with OFR vary according to contextual factors, there may, in any implementation, be a period of learning, such that regulatory arrangements may need to be refined over time¹⁰³ to take account of evidence derived from sectoral experience.

¹⁰¹ See Deighton-Smith (2008).

¹⁰² Coglianesi, Nash and Olmstead (2002) note that principles/outcomes based approaches can impose excessive costs on smaller firms because they have to search out ways of complying, and that some firms may simply prefer to be told exactly what to do.

¹⁰³ For example, the extent to which a regulated community embraces responsibility; the degree of trust between the regulated and regulators; changes in the nature of risks or the relative risk-aversion of regulatees etc.

5. Assessment of the rationale for the proposed changes

This section focuses on assessing the rationale for the proposed changes to the SRA Handbook. In particular, it focusses on exploring the specific reasons why the various changes outlined in section 2 above are considered necessary, and the potential, in-principle, benefits and risks of the changes. The possible impacts attached to these benefits and risks are then considered in section 6.

In considering the rationale for each of the specific changes, the discussion takes account of changes to the legal services market (as discussed in section 3) and the framing issues discussed in section 4, such as the wider rationale for legal services regulation, and the need to strike an appropriate balance between consumer protection regulation and competition, particularly in contexts of market change.

5.1 Simplifying and restructuring the Handbook

It is proposed that the Handbook be simplified and restructured to make a clearer separation between regulations that apply to solicitors as individuals, and regulations that apply to regulated providers. According to the SRA, the current Handbook contains areas of overlap between individual and entity regulation. For example, individual solicitors are subject to different obligations depending on the type of entity that they provide services through.

One of the stated rationales for the proposed changes is to make clear to solicitors, regulated entities, consumers and the wider public the core set of principles that apply to solicitors and regulated entities. Individual solicitors will be subject to a set of core regulatory principles and code of conduct irrespective of whether they practise in a traditional regulated provider, in a provider not authorised by the SRA (or another legal regulator), or in-house. These core principles and code of conduct will focus on competence and ethics, values and appropriate behaviour. Regulated providers will be subject to a set of minimum standards and code of conduct irrespective of the business structures that they operate within. The standards and code will focus on business protections, systems and control processes.

In a nutshell, the changes appear to be directed at making regulatory requirements less complex, proportionate and accessible. From an economic perspective this could lower the costs of compliance for those regulated, and enhance consumer and public understanding of regulatory protections in ways that build confidence in providers and are market expanding. The simplification should also allow regulation to keep in step with some of the wider market changes discussed in section 2, in particular the increasing diversity of business structures in which legal services are being provided. This should address the SRA's concern that the current structure of the Handbook has complicated its ability to develop regulation for different types of provider, such as multi-disciplinary ABSs, and solicitors who work in providers that are regulated by other

approved legal regulators.¹⁰⁴ The restructuring is also necessary to accord with other proposed changes, particularly the change to allow individual solicitors to provide non reserved activities through alternative legal services providers (discussed below). Finally, a simple Handbook could instil greater confidence in consumers who have a better understanding of the minimum service standards they can expect of solicitors and regulated firms, which can be market expanding.

There are some, in-principle, risks associated with this proposal. In particular, to the extent to which the simplification and restructuring creates material gaps in coverage, this can lead to discord with policy objectives, which can impact on consumers. The extent to which this risk will arise in practice will depend greatly on the content of the principles and codes of conduct and whether they are sufficient to cover all circumstances that may arise in practice. A further risk is that the simplification results in unintended changes to the established meaning or understanding of words and concepts, this might impact on the achievement of regulatory objectives.

5.2 Reduction in Handbook size and removal of redundant requirements

The SRA is proposing to reduce the size of the Handbook and remove redundant or duplicative requirements. It is expected that the size of the new Handbook will be substantially reduced to around 50 pages from its current size of around 400 pages. Some of this reduction in size will come from the removal of requirements that are covered by other laws and regulations.

The SRA is of the view that the current Handbook is too large and complex, and that because of the level of detail contained in the Handbook it needs regular amendment to remain up to date with relevant developments. This is particularly problematic given the pace of change in the legal service market (as described in section 3). Moreover, some of the detail in the current Handbook is relevant only to certain solicitors or types of business practices and only at specific points in time – for example the requirements relating to overseas and specialist services, or authorisation proceedings. This can make it hard to navigate, and potentially means that the SRA risks over-regulating in certain areas. The Handbook also contains a significant amount of material which has been copied across from legislation and case law. The inclusion of such material directly in the Handbook in itself creates a need for regular changes to the Handbook.

In addition, the SRA is seeking to remove provisions that are related to risks which are adequately covered by other pieces of legislation. For example, the Handbook contains some regulations providing specific consumer and client protections. However, as general consumer protection laws and other laws (such as data protection) have been introduced, these specific additional protections are becoming less important. Removing these provisions can avoid the risks of ‘gold plating’ generally applicable regulations, or of duplicating requirements in a particular area via multiple instruments, which can unnecessarily increase the costs and burdens of regulation.

¹⁰⁴ Solicitors Regulation Authority (2015a).

The SRA's expectation is that a Handbook which is substantially reduced in size, and in level of detail, will provide an accessible, one-stop document where both solicitors and regulated entities can easily ascertain the specific requirements that apply to them.

As a general observation, there is no common size for 'Handbooks' or similar compendiums of regulatory requirements observed across regulated sectors. In some areas, such as the energy sector, many of the requirements are contained in highly technical codes, some of which can be long, however in other areas, these documents can be relatively short. The critical criteria in any case is whether the information is accessible and comprehensible to its target audience. If a Handbook or compendium is intended for a wide, non-technical audience, such as consumers or the public at large, then it may be particularly important to ensure it is not unduly lengthy or inaccessible. However, even among technically-proficient regulatees, large and complex documents can be undesirable. Behavioural economics research suggests that large and complex documents can create attention bias in readers, leading them to rely on heuristics and rules-of-thumb. This may be particularly problematic in an outcomes-focused regulatory approach where regulatees are expected to think through how their actions contribute to, or hinder, desired outcomes.

Reduction in the size and complexity of the Handbook is also hoped to improve the understanding of both regulatees and consumers of the basis on which enforcement actions and decisions are taken. According to the SRA there are currently 40 to 50 different rules invoked for enforcement action. This can result in poor signalling of why an action was taken, which can, in turn, reduce the disincentive effects on other regulatees of the enforcement action, as well as reducing the confidence of consumers and the general public that appropriate action will be taken for contraventions of regulation.

Again, the in-principle, risks associated with reducing the size of the Handbook and removing redundant requirements relate to the creation of material gaps in regulatory coverage, and mitigation of this will lie in the specifics of how this change is implemented.

5.3 Refinement of outcomes-focussed regulatory strategy, including replacing non-binding Indicative Behaviours and guidance

The SRA proposes to refine its implementation of the outcomes-focussed approach to regulation in two material respects. Firstly, it proposes to reduce the number of principles and standards to which regulatees are subject, and cast those that remain more clearly. Secondly, it proposes to more clearly separate binding regulatory requirements from non-binding regulatory guidance. In particular, it is proposing to remove non-binding Indicative Behaviours and guidance from the Handbook and to replace these with online resources such as case studies and toolkits. In developing the case studies and toolkits the SRA proposes to work collaboratively with a range of bodies, including trade associations and other groups.

There are a number of potential, in-principle, benefits of such refinements. Firstly, moving the non-binding elements outside of the Handbook should create greater clarity for solicitors and regulated providers as to the status of different requirements. Secondly, the change will make it easier to update the non-binding guidance/toolkits/case studies to remain in step with changes in the market, and any specific problems that emerge. In this respect, the regulatory assistance provided can be more dynamic, which may be particularly important where, as in legal services, a sector is undergoing rapid and significant change. Finally, making some of the principles and standards more general, and the methods for achieving these less prescriptive, may better encourage regulatees to think through the consequences of different courses of action. As discussed in section 4, a benefit of OFR is the potential to foster a regulatory mindset focussed on complying with a regulatory objective rather than a specific prescriptive rule, which can allow for new and innovative ways of compliance to develop across the diverse areas regulated, while at the same time capturing a wide range of behaviours. In this way, it can avoid large enforcement or compliance gaps emerging. Such an approach can also build the capacity of those being subject to regulation, encouraging a proactive relationship with regulatory objectives rather than a reactive response to prescriptive rules.

However, the proposed changes also raise some potential regulatory risks. Reducing the number, and increasing the generality, of principles and standards raises the risk of increasing uncertainty among regulatees as to what actions will constitute regulatory compliance. As discussed in section 4, such uncertainty can result in over- or under-compliance. Under-compliance obviously raises risks for the achievement of regulatory objectives, however over-compliance can also have undesirable effects – in particular by unnecessarily increasing costs for regulatees, and potentially leading to the emergence of a third-party compliance industry ready to capitalise on such uncertainty. As a general observation, it might be expected that solicitors and regulated legal service entities should be better equipped than other professions and areas of regulation when it comes to dealing with vagueness or uncertainty in legal provisions or regulations. Nevertheless, the time and cost implications of dealing with undue uncertainty mean that, in combination, the binding principles and standards and non-binding guidance must be sufficiently eloquent to provide solicitors and other regulated firms with the basic information they need to understand what it means to be compliant with a specific regulatory principle or standard.

A second general risk associated with the move to fewer, and more general, principles and standards, and a clearer delineation between the binding and non-binding elements of regulation, is that the regulator itself does not sufficiently adapt its own enforcement behaviour and processes to these changes. In particular, the regulator will need to moderate its approach to enforcement to match the increasing discretion afforded to regulatees under the approach – e.g. by recognising the potential for differences in interpretations that might arise in specific factual contexts. In this respect, the culture of the SRA, and its adaptability to the proposed changes, will be important. For example, it would be inconsistent with the rationale of the proposed changes for the SRA to give excessive weight, in its enforcement activities and decisions, to forms of compliance detailed in non-binding case-studies and to treat with suspicion other, novel, ways regulatees may seek to meet an objective.

5.4 Development of public and business facing guides

The SRA proposes to develop a series of public and business facing guides to accompany its changes to the Handbook. These guides are intended to help consumers of legal services, and the wider public, to understand what protections they have in dealing with solicitors and different types of providers, and to clarify the minimum standards of service and conduct they can expect. The SRA are also proposing to develop tools to help consumers choose the right legal services for their needs.

Such guides are intended to address what is perceived to be current confusion among some consumers about what solicitors offer – and how this compares to other service providers – as well as their rights when obtaining such services. For example, the Law Society has noted that: “[D]espite the volume and significance of changes in the legal marketplace, the public on the whole remain confused about what a solicitor can offer them and about their own rights as purchasers.”¹⁰⁵ In addition, as the Law Society observes, this confusion extends to ‘knowledgeable consumers’ who can find it very difficult to work out which provider is most appropriate for their needs. However, as already noted, other research suggests that market rationing operates to channel more severe problems towards advice and formal processes, including independent help and law firms.¹⁰⁶

In principle, the benefits associated with providing public and business facing guides include making it clearer to consumers which type of provider is most suited to their needs and requirements. To the extent to which this additional information empowers consumers, this can potentially result in more active and engaged consumers, which can, in turn, expand the legal services market. In this respect, such guides could potentially address some of the problems associated with unmet demand that were identified in section 3. The guides will also be important in the context of other proposed changes – particularly the proposal to allow solicitors to provide legal services through alternative legal services providers. An important benefit of such guides in this context could be in assisting consumers to recognise the differences between providers – such as regulated and alternative legal services providers, or those providing services on the Internet – and to understand the different service levels and protections they can expect in relation to each type.

It is difficult to identify any, in-principle, risks associated with the development of public and business facing guides. However, there are obviously potential risks if such guides are poorly developed, and serve to increase customer confusion and dis-engagement from the market. Accordingly, careful thought will need to be given to the various target audiences of such guides, the information to be included and the accessibility of such information.

¹⁰⁵ The Law Society (2016).

¹⁰⁶ See Pleasence and Balmer (2014).

5.5 Allowing solicitors to deliver non reserved activities through alternative legal services providers

An important change being proposed by the SRA is to remove requirements that currently restrict individual solicitors from delivering non reserved activities to the public, or a section of the public, by practising outside a regulated provider. Specifically, under the current regulations, solicitors who work in providers that are not regulated by the SRA, or another approved legal regulator, cannot provide non reserved activities to the public, except in some specific circumstances.

The SRA is of the view that these regulations are having a number of adverse impacts on competition and consumers; in particular, that they restrict choice for consumers by not allowing them to access the services of a solicitor outside a regulated provider. Moreover, the SRA is of the view that the regulation limits the opportunities for solicitors to choose to work in a range of different providers. This, in turn, could be limiting competition and innovation in supply models to the ultimate detriment of consumers.

In proposing to remove this requirement, the SRA's aim is to allow solicitors the flexibility to deliver non reserved activities through a range of different business structures and alternative legal services providers. Solicitors will be able to deliver non reserved activities in ways which are most responsive to their customer needs and consistent with their business strategy.

In considering the, in-principle, merits of this proposal it is necessary to briefly explore how the existing restrictions evolved, and to consider whether such a framework is still relevant. Prior to 2007, most solicitors practiced in traditional solicitor firms, or as employed solicitors providing advice to their employers.¹⁰⁷ Traditional regulated providers delivered both reserved and non reserved activities, and were subject (as they are now) to a mix of individual and entity-based regulation. That is, some consumer protections were directed at the regulating the conduct of individual solicitors, while some protections were directed at regulating the entity in which the solicitor practised. However, as discussed in section 3, since 2007 there have been significant changes in how legal services are delivered. There is now a range of providers who provide legal services, including traditional solicitor firms and ABS providers, and providers regulated by other approved legal regulators. There are a large number of solicitors who are now working in-house or on a contracting basis. There is also substantial provision of non reserved activities by non-solicitors/ non-solicitor firms. Given these changes, the SRA's view is that the restrictions placed on the types of entities through which solicitors can deliver non reserved activities is no longer relevant and may be having adverse effects on competition, innovation and ultimately consumers.

From an economic perspective, there are a number of, in-principle, potential benefits associated with allowing solicitors to deliver non reserved activities through alternative legal services providers. Firstly, to the extent to which solicitors choose to provide advice through alternative legal services providers, this could increase competition in

¹⁰⁷ See Solicitors Regulation Authority (2015a).

the supply of these services. That is, solicitors could offer a differentiated service to those currently being offered by capitalising on their specific qualifications, skills and expertise to compete against the existing providers. In addition, to the extent to which solicitors are allowed to bring their expertise to operate in innovative or different businesses – such as legal technology or legal process outsourcing companies – this can facilitate innovation and new methods of service delivery, which can be market-expanding and potentially address some of the issues associated with unmet demand for legal services identified in section 3. Secondly, the proposed changes will expand the choice options for solicitors in terms of the types of businesses through which they can deliver non reserved activities. This could lead to an even more diverse legal market and one consistent with suggestions that there will be more rather than less opportunities for solicitors in the future.¹⁰⁸ Thirdly, it can allow in-house solicitors, including those working in membership organisations, charities and local authorities, to provide legal advice to the public, without the need to seek a waiver.¹⁰⁹ This could open up more opportunities for these providers to advise the public, or certain segments of the public, including vulnerable consumers. Finally, at a more general level, the proposed change will remove what might be classed as an asymmetric regulatory restriction. Currently, solicitors who are regulated by the SRA are restricted in how they can deliver non reserved services, while non-solicitors who deliver similar types of services face no such restriction. The proposed changes remove such restrictions and therefore ‘levels the playing field’ for solicitors and non-solicitors delivering non reserved activities to the public. The change will also address a trend that has been observed in the wake of this asymmetry, of some solicitors relinquishing the title solicitor so as to deliver advice through a firm that is not a regulated provider.¹¹⁰

There is a number of, in-principle, risks associated with the proposed change. Firstly, and most importantly, there may be concerns around certain consumer protections that will not be available under the new arrangements. For example, consumers will not have access to the SRA Compensation Fund, or to client money-holding rules or to mandatory professional indemnity insurance requirements¹¹¹ where a solicitor delivers non reserved activities through an alternative legal services provider. We understand that consumers may also not have the benefit of legal professional privilege in relation to advice provided through an alternative legal services provider (unless novel contractual arrangements are developed). There will also be no mandatory controls on the systems and processes of the business. Finally, consumers will not automatically have firm-wide protection in relation to any conflict of interest they have with other clients of the alternative legal services provider, as they do in regulated providers. That is, while individual solicitors in alternative legal services providers will be under a duty not to act where there is a conflict of interest between two or more of

¹⁰⁸ The Law Society (2016).

¹⁰⁹ The current waivers framework can be cumbersome and potentially confusing for solicitors, consumers and the public about what obligations apply to different types of solicitors. The SRA has issued 81 limited waivers, the majority to local government bodies and advice services, in relation to rules relating to in-house solicitors. See Solicitors Regulation Authority (2016).

¹¹⁰ See the Law Society (2016).

¹¹¹ It has been suggested in discussions that the minimum terms and conditions contained in mandatory regulated insurance requirements are generous to consumers and might not be replicated in standard commercial professional indemnity insurance arrangements.

their clients, this duty will not extend to any conflict between the solicitor's clients and clients served by others in the firm (subject to any voluntary policy the provider may have in this respect).

However, it should be noted that these protections are also unavailable if legal services are provided by firms who deliver non reserved activities through non-solicitors. Table 5 compares the consumer protections available under the three alternative supply models.

Table 5: Consumer protection by type of provider

Protection	Solicitor working in regulated provider	Solicitor working in alternative legal services provider	Non-solicitor working in non authorised provider
Individual solicitor is authorised and regulated by the SRA	✓	✓	
Individual standards apply to solicitor	✓	✓	
Solicitor subject to sanctions for misconduct	✓	✓	
Provider is authorised and regulated by the SRA	✓		
Mandatory insurance applies for loss due to negligence	✓	May have voluntary professional indemnity insurance	
Access to SRA compensation fund	✓		
Specific business/managerial standards apply to provider, including rules about the handling of client money	✓		
Provider's advice is subject to legal professional privilege	✓	May depend on novel contractual arrangements emerging	
Automatic provider-level conflict of interest protection applies	✓	May voluntarily have a conflict of interest policy	

Some specific concerns that have been expressed around the loss of certain protections for consumers under the proposed model are discussed later in this paper. At this stage, the relevant point is that there is no in-principle economic objection to allowing consumers to trade-off the protections they receive under different service/provider models where they perceive they receive benefits in relation to this trade-off, such as reduced prices or greater accessibility to a service. In short, it is not an economic issue *per se* to allow consumers to make market choices based on their risk-preferences, and such allowance is an increasing feature of other regulated industries.

However, a crucial related issue in allowing consumers to exercise such preferences is whether consumers are able to understand relevant distinctions – i.e. to recognise whether the entity through which they consult a solicitor is subject to legal services regulation or not, and to appreciate differences in consumer protections in each case. In this respect, the proposed Code of Conduct for Solicitors places information obligations on solicitors to advise their clients on how services are regulated and the protections available to them. It might also be expected that, in marketing their services, regulated entities will make much of the enhanced consumer protections available to users of their services, which might further highlight relevant distinctions to the market. In general, the extent to which consumers will make informed choices in this context will depend on effective implementation and enforcement of the regulated information requirements as well as any other communication strategies of regulators and market participants.

A further potential, in-principle, risk that may arise from allowing solicitors to practice in a range of providers – including non-traditional providers such as high-street retailers or other companies – is that this results in a reduction in the collective reputational brand of solicitors. A downgrading in consumer conceptions of the ‘solicitor’ brand could, in principle, have wider knock-on effects to the rest of the profession. As solicitors themselves will remain regulated they will, it might be argued, have strong disincentives to compromise professional principles such as would degrade their reputation. There is, however, a second discipline or check on solicitors in regulated providers, as the entity itself is subject to a regulatory requirement to have processes in place to ensure their employees comply with the regulatory arrangements that apply to them and such firms are also required to notify the regulator if they become aware of misconduct or regulatory breaches. The removal of this entity-level monitoring in the proposed new arrangements is not necessarily problematic from a regulatory perspective if the SRA’s supervision of individual solicitors is effective. In this respect, to the extent that the SRA has, to date, relied heavily on entity level supervision of solicitors in targeting its monitoring and enforcement activities, there may be a need to adapt its approach toward the individual level.

A separate risk relates to the stability of the provider through which a consumer receives legal services. Regulated providers are subject to certain obligations in relation to their business management processes. Specifically, regulated entities are required to monitor their financial stability and business viability as well as risks to their business arising from connected practices. Alternative legal services providers will not

be subject to these specific entity-level requirements. Again the potential significance of this risk must be assessed in relation to the type of services that solicitors will provide through alternative legal services providers – i.e. are these services of such a nature that the effects of business disruption or failure would have effects substantially in excess of the effects of failures in the provision of other types of non-legal services (for which no such provisions are available)? In addition, are these protections of a type that consumers might plausibly trade-off for other benefits in terms of supplier choice, costs or accessibility? Further, might other market information assist consumers in assessing business stability and viability? - e.g. where a provider is a large 'brand' or a listed entity etc.

Finally, we understand that legal professional privilege may not be available where a solicitor provides advice to a client through an alternative legal services provider. However, it has been suggested that there may be scope for novel contractual arrangements between consumers and individual solicitors, or between regulated providers and alternative legal services providers, that will allow such privilege to be retained. The scope for such arrangements to develop raises both legal and practical commercial considerations. However if, in practice, legal professional privilege is not available to consumers of alternative legal services providers, this could have potential market impacts. In particular, it could impact on the attractiveness of alternative legal services providers to consumers, and on the type of services such providers will offer. The extent of this impact is debated. On one view, the availability or otherwise of legal professional privilege may be of limited significance in the context of non reserved activities (having far greater importance in reserved activities, such as litigation). In particular, it is suggested that many consumers are unaware of privilege, or if they are aware, do not value privilege for the advice they are obtaining. However, others consider that legal professional privilege can be of high importance for some consumers and in certain non reserved activities (such as tax advice or will writing). In addition, there may be significant implications of legal professional privilege being unavailable where, for example, an alternative legal services provider supplies services in relation to matters that later become the subject of litigation. Even if consumers are prepared to forgo the benefits of legal professional privilege in relation to certain legal services, there will again be important issues around the need to advise such consumers on the implications of agreeing to forgo this benefit, and obtaining meaningful informed consent. In short, as with the unavailability of certain consumer protections discussed above, there will be a need to deal with any legacy expectations consumers may have when dealing with solicitors, of which legal professional privilege may be an important one.

6. Assessment of possible impacts

In section 5 we assessed the rationale for the proposed changes to the SRA Handbook, identifying some of the, in-principle, potential benefits and risks associated with the changes. This section builds on this analysis, to consider and map out some possible impacts of the proposed changes on competition and innovation, and on different types of stakeholder (consumers, solicitors, providers). As emphasised throughout this paper, these possible impacts are assessed having regard to the current and expected changes in the legal services market identified in section 3 (i.e. the relevant context).

The approach adopted in this section is that, from an economic perspective, what matters is how the changes to the Handbook impact on behaviour, which in turn has wider economic effects, rather, than say, how the wording or presentation of regulation changes. Specifically, the key areas of focus are whether the proposed changes could: encourage entry by new providers or expansion by existing providers; increase (or decrease) costs, price and quality of legal services; increase (or decrease) consumer confidence and therefore expand (or contract) consumer choice in the market; and decrease (or increase) the incentives for innovation.

In considering possible impacts, the approach adopted in this section follows the standard approach to exercises of this type (albeit at a more general and abstract level). Specifically, it follows four steps:

- (i) It sets out the problem that is sought to be addressed by the proposed changes to the Handbook.
- (ii) It sets out, in a very general way, possible options for addressing the problem identified, including a 'do nothing' approach.
- (iii) It identifies the different categories or type of economic impacts that may be associated with the proposed changes.
- (iv) It maps the impacts across to different affected parties.

6.1 The problem

Previous sections of this paper have set out various specific 'problems' the proposed changes to the Handbook are seeking to address. For the purposes of the assessment of impacts, these problems, in aggregate, might be summarised in the following way:

The current version of the SRA Handbook may be limiting consumer choice, competition and innovation because it:

- *is large and over-complex, contains some redundant provisions and is too prescriptive in some parts;*

- *is insufficiently clear in delineating between regulation of solicitors and the regulation of entity providers;*
- *restricts the ability of solicitors to deliver non reserved activities outside regulated providers; and*
- *is not fit for purpose given the changes that have occurred, and are occurring, in the legal services sector.*

For the purposes of the discussion in the remainder of this section, we assume that the problems noted above are correctly specified – that is, it is accepted that these are problems with the current model and approach. Our focus is therefore to, first, consider alternative options for addressing the problems, and second, identify possible impacts associated with the SRA’s preferred option for addressing the problems.

6.2 Alternative options for addressing the problem

In sections 2 and 5 we set out, and then assessed the rationale for, the changes that are being proposed to the Handbook by the SRA. It is, however, worth briefly considering, in a general way, whether the problem identified above could be addressed through alternative approaches.

A ‘do nothing’ approach

It is standard practice in assessments of the impacts of different policies to consider whether the specific problems identified are capable of being addressed in the absence of further regulatory action. This is sometimes referred to as the ‘do nothing’ or ‘baseline’ option. In this context, the ‘do nothing’ approach might involve making minor changes to the current regulatory model and to the Handbook to address specific issues (such as removal of duplicative requirements) and to update the current Handbook to reflect changes in the legal services market. Put differently, the question is whether the problems identified could be addressed through the existing regulatory model.

Looking at the nature of the problems set out above, this approach could potentially address some of the problems identified by the SRA. For example, efforts could be made to address the specific provisions that are considered to be too long or complex. Similarly, it might, in principle, be possible to make it more clear that Indicative Behaviours are non-binding – for example, by placing them at the back of the Handbook or as an appendix. However, for some of the other problems identified it seems unlikely that they could be accommodated without more radical change to the Handbook. For example, efforts to more clearly delineate the regulations that apply to solicitors as individuals and entities, and to specify requirements or adaptations where solicitors are providing services through alternative legal services providers, will arguably necessitate a fairly significant restructuring of the Handbook.

The question of whether the removal of some of the restrictions could be

accommodated within the current regulatory model, absent the changes proposed, is a debatable one. If the policy position is that these restrictions can, in certain circumstances, limit customer choice and competition then one possibility might be to maintain and expand the current waiver system. For example, solicitors who wished to deliver non reserved activities through an unauthorised provider may be able to apply to the SRA to waive this requirement on a case-by-case basis. Put simply, an 'opt-out' approach could be applied. However, experience of the use of widespread waiver systems in other regulated contexts suggests that this could develop to be a complex and potentially confusing approach for solicitors, consumers and the general public.

Finally, there is the question of whether the current model is sufficiently fit for purpose given the changes that are occurring in the legal services market as outlined in section 3 above, including greater diversity in the profession, business structures and delivery methods. The current Handbook, may, in principle, be able to be adapted to accommodate such changes, however, this may require further expansion of the Handbook to cover a widening range of circumstances and behaviours, and may also involve frequent changes over time. The risk in this respect is that the Handbook becomes longer, more complicated, and less accessible to solicitors, consumers and the public.

A shift towards greater reliance on self-regulation and the market

An alternative option in responding to the problems identified might be to go further than the SRA proposals, and make even more significant reforms to the regulation of legal services. For example, it might be argued that, given the pace and nature of change occurring in the legal services market, a combination of competition and market reputational mechanisms, aligned with a minimum framework of additional regulation to ensure consumer protection, is the most appropriate approach. This approach might be based on an assessment that regulation is itself a cause of some of the problems identified, and is restricting consumer choice, competition and innovation rather than facilitating it.

Although there are many possible variants of this approach, one possibility would involve a more radical restructuring of the Handbook, including the removal of even more restrictions, to focus only on key areas of potential consumer harm. For example, specific requirements in the Code of Conduct about standards of service and complaints handling might be removed on the basis that, as in other professional services contexts, there will be natural market incentives for solicitors to foster and maintain a reputation for high standards and fair dealing (i.e. by effectively dealing with complaints).

The appropriateness of this approach clearly depends on a number of factors. One factor is the intensity of competition in the market, and whether such competition is sufficient to ensure services are competitively priced and of sufficient quality to protect consumers (see discussion in section 4 about the interaction between competition and consumer policy). Another factor to be considered is the wider rationale for legal

services regulation. This topic was also considered in section 4, where it was noted that among the reasons that legal services remain subject to sector-specific, rather than just general consumer protection, regulation is because of concerns about: asymmetric information; the way in which legal professionals have historically organised themselves; and the link between high quality legal services and economic performance.

Taking these points into account, it can be conjectured that the option of making more radical changes to the Handbook by removing further restrictions would like only be valid in circumstances where it was concluded that: (1) competition is sufficiently intense that it delivers good price and quality outcomes for consumers; and (2) the various specific rationales for legal services regulation are no longer valid, as competition is addressing concerns about asymmetric information, ensuring an open and diverse profession, and maintaining the high quality of legal services required for a robust, functioning economy.

Applying all existing regulated consumer protections to alternative legal services providers

A third option might involve attempting to bring all consumer protections that apply to legal services provided by authorised entities to attach to legal services provided by solicitors in alternative legal services providers. In particular, to allow clients of solicitors working in alternative legal services providers to have access to the SRA compensation fund and legal professional privilege, and to be covered by mandatory professional indemnity insurance and client money-holding requirements.

While attractive in principle, there are a number of potential problems that could arise from a practical point of view. First there is a question about the SRA's legal and practical power to influence alternative legal services providers (which it does not regulate). Second, if it is necessary to devolve current entity-level obligations to individual solicitors, this might place impractical burdens on individual solicitors. This could deter solicitors from working in alternative legal services providers and therefore not address the specified problem of limited consumer choice, competition and innovation.

6.3 Typology of impacts

The standard approach to assessing impacts associated with proposed policy changes is to assess such impacts relative to a counterfactual, or benchmark, which is the current policy situation. Although the impacts of all possible options are typically assessed as part of a policy proposal, our focus in this paper is assessing the possible impacts associated with the SRA's preferred policy option as described in section 2. Moreover, the focus is solely on economic impacts, and not on impacts in other areas, such as social or environmental impacts.

In terms of economic impacts, we have specifically focussed on the following:

- Impacts on choice (e.g.: entry, expansion and exit of providers)
- Impacts on price and costs (including compliance costs)
- Impacts on quality
- Impacts on enforcement
- Impacts on innovation
- Impacts on demand, and access to justice
- Wider economic impacts associated with the changes.

Having discussed, in a general way, how the proposed changes might impact on these dimensions, the following sub-section then maps these impacts across to the different types of affected parties.

Impacts on choice - entry, expansion and exit

The main elements of the proposed changes to the SRA Handbook that are likely to have a material impact in terms of the entry, expansion or exit of providers are the changes which will allow solicitors to deliver non reserved legal activities through an alternative legal services provider. As noted above, in principle this will allow solicitors operating through alternative legal services providers to compete directly with solicitors providing services through regulated providers, as well as with non-solicitors who deliver non reserved activities. The changes would also allow solicitors working in-house to provide advice directly to the public, although such a possibility may be contractually proscribed within a specific employment relationship.

The impact on entry of this change will depend on a number of factors. Among the most important are: the extent to which solicitors, including in-house solicitors, choose to compete directly with other providers in different areas of law; and related to the above point, the extent to which consumers consider the services provided by solicitors operating in alternative legal services providers to be substitutable for those provided by solicitors in regulated firms, or by individuals who are not solicitors who provide similar services.

There is an obvious connection between the supply-side incentives for solicitors and providers to enter or expand their activities, and the demand-side behaviour of consumers in terms of whether they would be willing to switch to new and alternative providers. Accordingly, it can be conjectured that if: a large number of solicitors do not take up the opportunity to deliver non reserved services through alternative legal services providers, or consumers do not consider such services to be substitutes for the services provided by others, there would likely be only a minimal impact on entry and expansion, and therefore competition.

If, on the other hand, large numbers of solicitors do, over time, choose to deliver non reserved activities through alternative legal services providers, and consumers do see these services as substitutes for those provided by solicitors in regulated firms, or by non-solicitors who provide similar services, a material impact on entry, expansion, and therefore competition, can be anticipated.

The key point is that the extent of entry and expansion, and the associated competitive impact, will depend significantly on supply-side (i.e. number of solicitors who deliver non reserved activities through alternative legal services providers) and demand side responses (the extent to which consumers see the services offered by such solicitors as substitutes).

One factor in the demand side response to alternative legal services providers is the extent to which consumers value the particular consumer protections that attach to provision through a regulated provider, including the significance of retaining legal professional privilege in relation to the services sought. These matters may have a higher significance in relation to certain legal services than others. For example, the balance may fall differently for drafting an employment contract to structuring a transaction, or in the context of drafting a will in sensitive circumstances.

There are different views on the potential scope for in-house solicitors to provide advice to the public under the changes. On one view, the change will have little impact because employers will be reluctant to allow their employee solicitors to provide advice to third parties. Another view is that it may be attractive to organisations where the in-house team wants to create a separate legal function, and where such a team could be 'spun off' into a separate entity. It has also been suggested that the changes could be particularly attractive to some charities and local authorities who wish to provide legal services or advice direct to the public.

A further consideration is the potential size of the market for non reserved activities. According to the SRA, as a rough estimate, the majority of work undertaken by larger firms is non reserved, while for smaller firms, approximately two-thirds of the work undertaken involves reserved activities. This implies that expansion of activities of current providers into non reserved activities might be more likely to occur for larger providers than for smaller providers.

There is also the possibility that the changes might result in some market exit. For example, if solicitors who deliver non reserved activities through alternative legal services providers directly challenge, and attract a significant volume of business away from, smaller regulated providers. While this type of exit is a function of the competitive process, and should not be seen as a negative impact if it also leads to better outcomes for consumers, it is potentially complicated in the case of legal services by difficulties associated with exiting the sector. Specifically, some regulated providers may see their custom and revenues drop, but may not be able to fully exit the sector because of an inability to fund the appropriate run-off insurance etc. However, to the extent to which this impact arises, this requires separate consideration.

Finally, it should be noted that some regulated providers, who do not undertake reserved activities (or very little), may choose to relinquish their current regulated status, and only undertake non reserved activities. Again, although these providers are 'exiting' the regulated sector, they are not exiting the supply of non reserved activities. They are, however, exiting the supply of reserved activities.

Impacts on prices and costs - including compliance costs

In effectively competitive markets the ability of firms to price well in excess of underlying costs is typically constrained by the potential to be undercut by current or potential rivals. Assuming that there is a reasonable degree of competition in the provision of legal services, a key consideration is the impact that the proposed changes will likely have in terms of costs (including compliance costs) and the knock-on effects that this could have on prices for these services.

The potential impacts of the proposed changes on costs, and therefore prices, are likely to differ according to the specific proposal. The impact will also depend significantly on the effectiveness of measures introduced alongside each proposal – for example, whether the online resources and toolkits are more effective in allowing solicitors to understand what they need to do to be compliant with regulations relative to the existing guidance contained in the Indicative Behaviours. In addition, there are likely to be one-off or transitional costs, and on-going cost considerations to take into account. Taking each proposed change in turn:

- Other things equal, the proposal to simplify and restructure the Handbook (to more clearly separate the regulations that apply to solicitors as individuals, and regulations that apply to regulated providers) and to remove redundant and duplicative requirements, might be expected to reduce costs or result in no material change in costs over the long term. This is because to the extent to which they clarify regulatory requirements, this should reduce uncertainty and the potential costs associated with complying with redundant or duplicative requirements. There may, however, be some transitional costs associated with solicitors and providers having to adjust to the changes, in particular for solicitors providing services through non authorised entities where they take over certain obligations currently met at the entity level in relation to regulated providers. There may also be additional costs if the simplification results in unintended changes to the established meaning or understanding of words and concepts.
- The potential cost impact of changes to refine the outcomes-focussed approach, including the replacement of non-binding Indicative Behaviours and guidance with online resources such as case studies and toolkits, will depend significantly on the extent to which such changes reduce regulatory uncertainty. As discussed in sections 4 and 5, if the changes result in a situation where guidance emerges more rapidly in response to market developments, and regulated providers take advantage of the greater flexibility afforded them in choosing how to comply with principles or standards to experiment and innovate, this can potentially reduce the costs of compliance, and allow providers to price more competitively. On the other hand, if the changes increase uncertainty for solicitors and regulated providers, this could raise costs and ultimately prices.
- To the extent to which the proposed public and business facing guides improve consumer understanding of their rights and obligations, and reduce search costs,

this will allow consumers to exert greater service and pricing pressure on legal service providers. There may be some costs associated with the production of such guides, although it is unclear how material the costs would be and who would bear the costs.

- It is difficult to identify a direct cost impact of the proposals to allow solicitors to deliver non reserved activities through alternative legal services providers. There may be some indirect costs in terms of the potential insurance implications and other requirements that are placed on providers that employ solicitors (e.g. solicitors working in alternative legal services providers may face higher or lower insurance premiums than they currently do through a regulated provider).¹¹² This proposed change might reduce prices to the extent to which they reduce costs¹¹³ and intensify competition in non reserved activities. Recent surveys indicate that cost of services is now considered to be the most important factor when searching for a provider,¹¹⁴ and that unauthorised providers are seen as having a perceived cost benefit.¹¹⁵ Solicitors working in alternative legal services providers may offer consumers a price advantage relative to solicitors in regulated providers because such providers do not have to make payments into the compensation fund etc. On the other hand, consumers who suffer loss as a result of fraud by, or the inadequate insurance of, a solicitor in an alternative legal services provider, will not have access to the SRA compensation fund in relation to this loss (which is a cost to those consumers who would have been eligible for fund protection). The potential loss of legal professional privilege when obtaining advice from alternative legal services providers may also represent a potential cost to some consumers.
- Costs and associated prices might further be reduced in these circumstances if the alternative legal services provider is able to cross-subsidise some of the costs associated with employing a solicitor by revenues generated from other non-legal services that it provides. This is arguably already a possibility in relation to MDPs, however the change could increase the scope for service bundling and/ or cross-subsidisation across a wider range of business services and products. Nevertheless, the cost to consumers who use a solicitor through an alternative legal services provider may be higher than the cost of using a firm who employs non-solicitors to provide non reserved activities because of the premium the solicitor's skills and training is likely to cost the provider, as well as the need to absorb the solicitors' regulatory costs.
- Some currently regulated providers might choose to focus solely on non reserved

¹¹² In one discussion it was suggested that solicitors currently benefit from lower insurance premiums as a result of the ability to bulk purchase insurance. However, the SRA has previously found that for many firms – such as sole practitioners with low turnover or say £100k - £250k per annum and low levels of transactions - the level of compulsory cover may be above what is really needed. See Solicitors Regulation Authority (2014b).

¹¹³ It has been suggested, for example, that unauthorised legal service providers who send advice out to third party solicitors in certain areas will be able to provide cheaper services if such advice can be provided within the organization rather than through third party arrangements.

¹¹⁴ YouGov (2015).

¹¹⁵ See Pleasence and Balmer (2014).

activities and become alternative legal services providers, which would reduce their regulatory costs at the entity-level, and should, other things equal, allow them to charge keener prices (albeit without SRA consumer protections). As noted above, to the extent to which there are a fixed level of regulatory costs to be recovered this may have knock-on impact for those regulated providers who deliver reserved activities in terms of higher regulatory costs (i.e.: as a result of a fixed level of costs being recovered through a smaller number of regulated providers) and, other things equal, prices. This is not inevitable, and changes to charging methodology can potentially address this problem to some extent (i.e.: by re-balancing revenues obtained from individual solicitors and regulated providers).

Impacts on quality

As with the other economic impacts considered in this section, the potential impacts of the proposed changes on the quality of legal services are linked to each specific proposal. The proposals most likely to have an impact on quality are those to develop public and business facing guides and to allow solicitors to deliver non reserved activities through alternative legal services providers. Each of these is considered briefly in turn below.

The production of public and business facing guides is principally aimed at improving consumer understanding of their rights and obligations, and should be expected to lead to better-informed consumers. This in turn could reduce the information asymmetry that some consumers of legal services face, and increase the countervailing power they can exercise in dealing with legal providers. Other things equal, more empowered and knowledgeable consumers should be able to demand higher quality services from legal providers.

Allowing solicitors to deliver non reserved activities through alternative legal services providers could potentially lead to higher quality provision of non reserved activities. This is because solicitors can bring their skills, expertise and experience to these activities in a wider variety of business arrangements.¹¹⁶ However this depends on whether these attributes are valued by consumers – i.e.: some consumers may prefer to continue being supplied by non-solicitors. Some firms who currently provide non reserved activities but are not regulated providers are of the view that there will be demand for such attributes, particularly as paralegals are not perceived by some consumers to be as impressive a brand as solicitors.

However, concern has been expressed that solicitors acting in alternative legal services providers may face less quality oversight than in regulated providers, and pressure to provide poorer quality service. More particularly, it is argued that in traditional regulated law firms there is a strong commercial incentive on all solicitors in the firm to oversee and control quality because of the impact poor quality work by one solicitor will have on the reputation and livelihood of all solicitors in the firm. On this

¹¹⁶ For example, it has been suggested that solicitors could provide better and more accurate advice in housing sector disputes.

view, the proposed changes will allow legal services to be provided without an appropriate structure of control and oversight. The merits of this argument are beyond the scope of this assessment insofar as it relates, in part, to the wider issue of whether external non-lawyer parties should be able to own and control regulated entities (which is currently permitted under the ABS provisions). It also touches on questions of how the internal cultures and oversight practices of regulated providers and other providers differ, which is in essence an empirical question. However, as discussed in section 4, in principle, irrespective of the internal culture and practices of the provider, the quality of service provided by an individual solicitor should be conditioned by the minimum standards expected of all solicitors under their code of conduct.

Finally, there is a question around whether any loss of legal professional privilege in relation to advice provided by solicitors in alternative legal services providers might influence the level of disclosure by consumers, and the manner or form in which advice is provided, in ways that impact on (service) quality. Similar questions might also be raised about potential impacts on quality associated with the loss of mandatory firm-wide conflict of interest protection.

Impacts on implementation and enforcement

Changes to regulation typically have an impact on regulators in terms of the relative burden and costs associated with implementing and enforcing regulations. There can also be indirect impacts in terms of the staff and capacity requirements of a regulatory agency. The proposals that are most likely to impact on enforcement activity, including costs, are those directed at refining the outcomes-focussed regulatory strategy and to allow solicitors to deliver non reserved activities through alternative legal services providers.

As discussed in section 4 above, one of the in-principle benefits of an outcomes-focussed regulatory approach is that it can capture a wide range of behaviours and avoid large enforcement or compliance gaps emerging. However, for the SRA's implementation of this approach to be effective it must be equipped with staff that are willing to, and capable of, assessing whether or not the judgements made by those subject to regulation are consistent with the principles and desired outcomes. This may have a cost dimension. More generally, enforcement costs could rise if the SRA's further refinement of the outcomes-focussed approach results in more opaque and vague provisions that are open to multiple interpretations, and lead to more disputes arising between the regulator and parties subject to regulation.

Allowing solicitors to provide non reserved activities through alternative legal services providers might, in principle, be expected to have a mixed effect on the implementation and enforcement of regulation, and it follows, on associated costs. As the scope of SRA entity regulation only applies to authorised firms, and not other providers of non reserved activities, the proposed change does not change this situation and no costs will arise in this respect. However, as discussed earlier, to the extent that the SRA has relied materially on entity-level supervision of solicitors in its monitoring and enforcement activity, the changes may require a greater monitoring and enforcement focus at the individual solicitor level, which may have costs.

Finally, the proposed change might be expected to reduce implementation and enforcement activity to the extent to which some currently regulated providers decide to focus only on non reserved activities (i.e.: become an alternative legal services provider) and therefore opt-out of entity regulation.

Innovation impact

Generally speaking, the relationship between regulation and innovation can be a delicate one. Well-designed, proportionate and targeted regulations can foster an environment conducive to innovation. In contrast, regulations that are poorly designed, insufficiently targeted, disproportionate or inadequately enforced, can stifle innovation and different ways of doing things. In principle, all of the proposed changes might be expected to have impacts on the incentives for providers to innovate. However, the most important impacts on innovation are likely to flow from the proposed changes to simplify the Handbook and refine the outcomes-focussed approach, and from allowing solicitors to deliver non reserved activities through alternative legal services providers.

As discussed in section 4, an outcomes-focussed approach to regulation can foster innovation in compliance insofar it affords regulatees flexibility to choose how their actions can best satisfy a regulatory objective. This flexibility can lead regulatees to experiment and seek out methods and practices that can reduce compliance costs and improve their position relative to competitors. However, this general benefit can be tempered in settings where there is detailed guidance in relation to the principles which is interpreted by those subject to regulation as being binding. In this respect, to the extent to which the proposed changes to the SRA Handbook make a clearer distinction between binding principles/standards and non-binding guidance, this may foster a better environment for regulatees to achieve the benefits of innovation which are available under the approach.

More generally, as noted, the outcomes-focussed approach can create conditions for technological innovation by allowing those subject to regulation the freedom to experiment with alternative processes and technologies, which might lower production costs or improve quality. As discussed in section 3, technological change, particularly developments in information technology, are having significant impacts on the legal services sector. To the extent to which the proposed changes provide solicitors with greater freedom to experiment in delivering outcomes, this could promote technological innovation in terms of the production and delivery of legal services.

Allowing solicitors to deliver non reserved activities through alternative legal services providers will provide solicitors with the freedom to offer their skills and expertise to the public within a wider range of business structures and delivery mechanisms. This may provide opportunities for innovative service bundling for consumers and other innovations in service delivery commensurate with the potentially great variety of non-law firms' business models. One possibility that has been suggested is that online legal exchanges will be further developed to allow consumers to put up jobs, and for individual solicitors to bid for work. At the moment such exchanges only allow for law

firms to respond to bids, but in the future the potential might exist for individual solicitors to participate and respond to individual jobs.

Impacts on demand, and access to justice

As discussed in section 3, a recurring area of concern is that there may be a significant degree of unmet demand for legal services. This unmet demand might, in turn, be seen as impacting the access that some consumers of legal services could have to justice.¹¹⁷ The main proposed changes which could impact on demand for legal services, and access to justice, are those directed at developing public and business facing guides and allowing solicitors to deliver non reserved activities through alternative legal services providers.

To the extent to which the development of public and business facing guides improve consumer understanding of their rights and obligations, instill a higher degree of confidence in the legal services market, and reduce search costs, this could encourage more consumers to purchase legal services. However, as discussed in section 7, for this to occur careful consideration must be given to the design of such guides to make them meaningful for consumers.

The ability of solicitors to deliver non reserved activities through alternative legal services providers could, in principle, lead to a greater number and diversity of providers of regulated legal services. Some of these providers might introduce new delivery mechanisms – for example, through retail outlets or via the Internet – which could tap into unmet demand for a service of regulated quality provided through less intimidating or more convenient avenues.¹¹⁸ The potential for new entry, and expansion of providers, who have new delivery mechanisms might lead providers to target consumers of legal services in different, non-traditional ways. This effect may be significant as some (current) unauthorised providers estimate that around half of their customer base consists of consumers, including small and micro business consumers, who would not have taken legal advice from a traditional regulated provider.

One potential risk of the changes is that, as noted above, it may lead to the exit of some current providers, particularly smaller providers, who may not be able to compete with larger alternative legal services providers who attract away substantial amounts of their non reserved activity work and undermine their profitability. While, as noted, the exit of providers is a normal part of the competitive process, it could potentially

¹¹⁷ On the basis of their analysis of how people resolve legal problems, Pleasence and Balmer (2014) draw the following conclusion: “*Our findings do not suggest any broad crisis of access to justice, with market rationing operating to channel more severe problems towards advice and formal process and some inaction appearing entirely rational. However, the legal services market and civil justice system do not ensure fair and equal access to justice, with deficiencies attributable largely to the difficulty of enabling vulnerable populations with limited capability and resources (e.g. those with health problems, low levels of education and/or lower income) to access appropriate help in a complex legal services market in which innovations to broaden service reach have often emanated from outside of the traditional legal professional sphere.*”

¹¹⁸ In a 2014 survey of 500 adults around a third of respondents said that they would be willing to try national brands supplying legal services. IRN Research (2015).

have impacts on demand and access to justice if the exit of such providers is concentrated in specific geographical locations or particular customer segments.

Wider economic impacts associated with the changes.

In section 4, it was noted that a well-functioning legal system can have important impacts on economic performance, insofar as it can reduce transaction costs and facilitate trade and exchange. In this way, well-functioning legal systems can assist in expanding market activity throughout the economy. The relevant question is whether the proposed changes to the Handbook might impact on transaction costs in ways that could facilitate, or hinder trade and exchange, and expand (or contract) economic activity in other markets.

It is difficult to make any definitive assessments on how the proposed changes might have wider economic impacts. However, it is possible to speculate that, to the extent to which the proposed changes remove unnecessary restrictions on trade, this may result in the development of alternative delivery mechanisms and service provisions which could reduce transaction costs. For example, solicitors who offer their expertise and skills to the public from within an IT or legal technology firm may be enabled to do so through innovative mechanisms – such as online products and services. These products and services might reduce the time and cost associated with acquiring legal services and lower transactions costs. Some existing tech-based non-law firms claim that they are able to increase the speed of contract management and reduce the costs of contracting by as much as 30-40%.¹¹⁹

These products and services might also broaden the access points for some consumers, making it easier to access legal advice and services, including in relation to risk, which could increase confidence in transacting. Conversely if the proposed changes fail to address, or increase, consumer confusion and uncertainty this can reduce confidence in the legal services market and could increase transaction costs.

6.4 Mapping impacts to specific affected parties

The previous section focussed on identifying different types of impacts, which cumulatively, are likely to impact on competition and economic welfare. As is standard with assessments of this type, the next step involves mapping across the impacts to different types of affected parties. In the current context the specific affected parties include:

- Consumers
- Solicitors
- Regulated providers (including small providers)
- Firms who provide non reserved activities through non- solicitors

It is not the purpose of the current paper to assess the likelihood or magnitude of the

¹¹⁹ For example, Axiom (see: <http://www.axiomlaw.com/what-we-do/service/contracts>)

possible impacts to specific affected parties identified. Rather the aim is to simply map impacts across to different types of affected party.

Possible impact on consumers

There is enormous diversity in in who constitutes the ‘consumers’ of legal services. Some consumers are large businesses who are repeat buyers, other consumers are smaller businesses, households or individuals who only infrequently acquire legal services at specific points in time (for a house purchase, to make a will etc.). Other consumers are what might be termed ‘involuntary’ in that they need to acquire legal services at specific points in time or in distressed circumstances (e.g.: those involved in a divorce, or in relation to employment matters upon being made redundant).

The relevant point is that the consumers of legal services differ significantly in terms of: the specific services they acquire (reserved or non reserved activities; criminal, civil, commercial or business advice etc.); the frequency with which such services are acquired; the circumstances in which they acquire legal services; familiarity and experience with acquiring such services and their ability to understand and specify their preferences and requirements.

One of the main direct consumer impacts of the proposed changes will flow from allowing solicitors to deliver non reserved activities through a range of alternative legal services providers, some of which may not provide the same level of protection that consumers of regulated providers may be familiar with. Consumer impacts will also flow from proposals to produce public and business facing guides, and from the ability of some currently unauthorised providers to seek to be regulated by the SRA.

In general terms, consumers can be expected to benefit from the proposed changes to the extent that they: improve consumer understanding of the legal services market; widen the number of providers and delivery mechanisms available to consumers; allow consumers increased access to the high standards of professionalism and education that is provided by solicitors; and allow some consumers to trade-off some protections for additional benefits. Moreover, to the extent to which the changes result in more intense competition and innovation this might ordinarily be expected to benefit consumers in the form of lower prices, alternative pricing arrangements, higher quality and the introduction of new products and services. All of this might draw more consumers into the market and address concerns about unmet demand.

On the other hand, and again in general terms, some consumers may be adversely impacted by the changes if they create confusion around the different protections attaching to services provided by solicitors through regulated providers and alternative legal services providers – e.g.: a mistaken belief that in gaining advice from a solicitor through an alternative legal services provider they are subject to the same protections as if that solicitor worked in a regulated provider (for example, the SRA compensation fund protection; the availability of legal professional privilege in relation to information imparted and advice provided; regulated indemnity insurance levels). As discussed elsewhere, separate concerns have been raised in some quarters that consumers may receive lower quality services from solicitors in alternative legal services providers. The

reasons cited for this include: the loss of regulated entity-level supervision; the potential loss of legal professional privilege in relation to information imparted and advice provided by such solicitors; and the loss of automatic firm-wide conflict of interest protection.

Having regard to these general points, it is possible to speculate on how different broad categories of consumer might be impacted by the proposed changes.

Business consumers who have a good understanding of the legal services market and are typically repeat buyers – such as medium and larger businesses – might benefit from the changes insofar as they result in more supply options and a greater diversity in providers. It may also provide them with greater scope to purchase unbundled legal services from a range of providers or bundled services (legal plus other services) from a single provider. In addition, such consumers are likely to understand their rights and protections under different providers, and might, it would be assumed, actively seek to understand what level of protection they have (i.e.: whether a provider has an appropriate level of insurance, the implications of not having legal professional privilege etc). Some in-house solicitors have noted that they are under obligations to their employer to find the cheapest way of sourcing legal advice at the right level of quality, and that they sometimes do not obtain desired legal services for cost reasons. It has been suggested that the proposed changes will increase the scope for in-house lawyers to manage budget and risk by assembling their own team of individual solicitors to work on aspects of specific projects, rather than relying on a team supplied by a traditional law firm.

The impact on individuals is likely to vary significantly according to their specific legal need, their circumstances, and their familiarity with, and understanding of, the legal services market. Individual consumers who are ‘savvy’ and reasonably knowledgeable about legal services, might familiarise themselves with public facing guides offered and take the time to acquaint themselves with their rights and protections under different forms of provider. These ‘savvy’ consumers could potentially benefit from the changes insofar as it widens the potential pool of providers. It may also allow some of those consumers who are willing to be exposed to some risk, to trade-off certain protections (such as access to the compensation fund) in exchange for lower prices or alternative mechanisms of service delivery.

At the other end of the spectrum are consumers who are unfamiliar with the legal services market, infrequent purchasers of such services or in distressed circumstances (what might be termed ‘non-savvy’ consumers). There is the potential that such consumers may not fully understand that, in acquiring the services of a solicitor through an alternative legal services provider, they are potentially foregoing some of the protections that currently exist (e.g.: in terms of access to the compensation fund, regulated indemnity insurance requirements, the availability of legal professional privilege etc.). To the extent to which this confusion is not addressed by measures proposed by the SRA – such as requirements for solicitors working in alternative legal services providers to inform consumers of their rights and protections, or through the public guides and outreach programmes – then this could lead to decreased confidence in the legal services market, a consumer bias against certain types of

providers (reducing the potential benefits of the proposed changes) or more widespread avoidance of the legal services market.

As discussed in more detail in section 7 below, the potential for this situation to arise depends on a number of factors. In particular, such risks may be mitigated where: solicitors are required to make meaningful disclosures to consumers in relation to available protections; alternative legal services providers have their own commercial incentives to take out insurance and other protections; and the public outreach programmes are effective. Moreover, concerns around consumer confusion assume that there is currently a high level of understanding among consumers of the difference between regulated providers and firms who provide 'legal services' but are not subject to legal services regulation, and that the changes will create confusion around this understanding. However, research for the Legal Ombudsman has found evidence that consumers currently lack understanding about the difference between regulated and unauthorised providers and their respective options for redress.¹²⁰ In particular, some consumers are of the view that unauthorised providers are regulated. More generally, as the Law Society has observed, there remains a 'great deal' of uncertainty among consumers – including knowledgeable consumers – about the types of lawyers and legal services. Having said this, other research suggests that market rationing operates to channel more severe problems towards advice and formal processes, including independent help and law firms.¹²¹ In this respect, the extent of concern around the risk of consumer confusion in relation to the proposed changes must be conditioned by the state of existing consumer understanding.

In summary, the potential impact on consumers of the proposed changes might generally be expected to be a positive one for larger and more savvy consumers of legal services, while the potential impacts for less savvy consumers will depend significantly on the effectiveness of the proposed consumer information/guidance. More generally, as differing consumer protections will be available in relation to solicitors providing services through regulated providers and alternative legal services providers, a key matter will be the extent to which consumers understand the different protections attached to various providers.

Possible impact on solicitors

As described in section 3, there is increasing diversity in how solicitors are choosing to work and practise law. While a large number of solicitors continue to work in what might be termed 'traditional' law firms, who deliver both reserved and non reserved activities to a range of consumers, an increasing number of solicitors are working in alternative and increasingly non-traditional ways. This includes a substantial number of solicitors who are employed in-house and provide advice to a single client; solicitors

¹²⁰ Northumbria University (2014).

¹²¹ See Pleasence and Balmer (2014).

working through ABSs; and solicitors who work on a contract basis or undertake outsourced work.

All of the proposed changes to the Handbook are likely to have impacts on solicitors. The changes of the Handbook which are likely to have the greatest impact are those which change the structure and content of the Handbook, and those which remove requirements that currently restrict the ability of individual solicitors to deliver non reserved activities to the public, or a section of the public, outside a regulated provider.

In general terms, the changes to the structure and content of the Handbook could result in benefits for solicitors by clarifying their regulatory obligations, reducing their compliance burden (by removing duplicative or redundant requirements) and allowing them greater freedom and agency in determining how to comply with various principles and standards. The removal of Indicative Behaviours and non-binding guidance from the Handbook could also address any confusion that exists about the status of such materials. The proposed refinements of the outcomes-focussed regulatory approach might also reduce the frequency with which changes to the Handbook are made, and therefore the need for solicitors to constantly keep abreast of such changes.

Similarly, in general terms, allowing solicitors to deliver non reserved activities to the public through alternative legal services providers could benefit some solicitors by increasing the scope for them to leverage their specialist skills, knowledge and expertise into new areas, and through alternative providers and delivery mechanisms. Put simply, it broadens the supply routes through which solicitors can deliver non reserved services, and arguably, the potential consumers that they can target. This is likely to particularly benefit solicitors who are responsive to consumer needs and preferences,¹²² and those more willing to embrace technology. However, it could also benefit solicitors who wish to develop an expertise and presence in niche practice and advice areas.¹²³ A different, less sanguine, perspective raised in one stakeholder meeting is that the type of solicitors who might be attracted to alternative legal services providers may be solicitors with low levels of experience, or those who seek minimal oversight of the quality of their services.

Again in general terms, there is potential for some adverse impacts on solicitors associated with the changes. The changes to the structure and content of the Handbook could introduce the potential for misunderstanding of the new compliance arrangements, although as noted above, in principle, solicitors should be better equipped than most to understand, and deal with, regulatory changes. The move to more clearly delineate binding principles from non-binding guidance and to replace the detailed Indicative Behaviours with new forms of assistance, while being more

¹²² As the Law Society has noted more generally: “Solicitors who can reach out to help consumers clearly understand their issues and options, and market themselves as such, should do well as more providers enter the market and confusion around choice grows.” The Law Society (2016).

¹²³ As the Law Society has noted there is a general growth in the number of niche providers: “The number of niche firms has grown as solicitors identify an opportunity to service a particular market more competitively than larger, more broad-based firms. Niche practices, by specialising, often tend to be market leaders in their fields, possessing clarity about what the firm does and projecting a lucid brand message.” The Law Society (2016).

consistent with an outcomes-focussed regulatory approach, may create additional work from practitioners in determining how best to exercise their permitted discretion to best meet regulatory outcomes in their particular circumstances. This could increase the costs and time associated with compliance, and, in the event that it proves unduly onerous, lead to over- or under-compliance.

Allowing solicitors to deliver non reserved activities to the public through alternative legal services providers might have differential impacts on solicitors. As described above, those solicitors who remain in the regulated provider market may find themselves facing more intense competition from solicitors providing non reserved activities through alternative legal services providers. While this is likely to be beneficial overall for consumers, it could nevertheless have distributional impacts on solicitors who lose custom and revenue as a result of the changes.

More generally, there is some concern that allowing solicitors to provide advice through a range of alternative legal services providers – such as large retail outlets or a range of other consumer-facing firms – may in some way ‘water down’ or reduce the collective reputation attached to the ‘solicitor’ brand. In a nutshell, the concern is that it might result in a changed consumer conception of solicitors which could, in principle, have knock-on effects on the wider profession. To the extent to which the brand is ‘watered down’, solicitors may come to be seen like other service providers who are not subject to the same requirements of education, skills and integrity. However, an alternative view is that, rather than diminish the ‘solicitor’ brand, the proposed changes will strengthen it. On this view, the changes will increase the visibility and accessibility of solicitors, improving understanding of the specialist skills and knowledge they can offer. In addition, if solicitors come to be perceived as less ‘elite’, this may widen access and attract more consumers to use their services. Moreover, as the SRA notes, in this context, any reputational advantage attached to the brand ‘solicitor’ will depend on actual consumer experience, and the extent to which consumers see value in acquiring the specialist services of solicitors.¹²⁴

A different concern that has been raised in some quarters is that solicitors working in alternative legal services providers might face pressure from such providers to ‘cut corners’ or compromise their professional principles in the interest of commercial expediency. While it is not possible to predict whether conflict may arise between solicitors and their employers along these dimensions, the solicitor themselves will, as the regulated party, have strong disincentives to compromise professional principles.

Having regard to these general observations, the specific impacts on solicitors are likely to differ according to the structure through which they deliver legal services. It is possible to speculate on the possible impacts on broad categories of solicitor including those working in traditional legal structures and those who choose to work in alternative legal services providers, in-house or alternative arrangements.

Solicitors who continue to provide advice through traditional legal structures will be directly impacted by the changes to the structure and content of the Handbook. This

¹²⁴ Solicitors Regulation Authority (2015b).

could in principle reduce the regulatory burden that they face, although as noted, if not accompanied by appropriate and targeted guidance it may also increase uncertainty and potentially raise costs. As discussed, in section 7, within this broad category, solicitors working in some smaller traditional law firms may also face more intense competition from solicitors working in alternative legal services providers.

Some solicitors who currently work in traditional providers may take advantage of the removal of restrictions on how they can deliver non reserved services to leverage their skills and knowledge to target consumers who are currently supplied by non-solicitors providing similar services.¹²⁵ To the extent that there are non-practising solicitors who currently provide advice outside a regulated provider,¹²⁶ such solicitors will be able to become regulated by the SRA on an individual basis, and continue to provide such services, but under the 'solicitor' brand. Some solicitors working in-house are likely to benefit from the proposed changes insofar as they will be allowed to deliver non reserved activities to the public (subject to their employment contract). This benefit will particularly be felt by those solicitors working in membership organisations, charities and local authorities, which currently obtain a waiver in order to provide such services. In-house solicitors may also be able to benefit in terms of providing advice in terms of how companies manage and handle their risk exposures and appetites. Once developed, this risk-based advice could be provided to a wider range of consumers.¹²⁷ Solicitors who work on a contracting basis are also likely to benefit as it broadens the potential avenues and providers through which they can offer their specialist skills and expertise.

There may, however, be cost impacts for individual solicitors to the extent that they take over, in their individual code of conduct, some of the responsibilities traditionally performed at the entity level. For example, solicitors working in alternative legal services providers will have to establish and maintain, or participate in a complaints handling procedure. Similarly, to demonstrate compliance with some of the general high-level principles in their Code, solicitors may be required to develop and maintain certain policies, systems and processes which might traditionally have been, in practice, part of the regulated providers regulatory remit of establishing compliant business systems. Finally, there is a question around whether the scope for solicitors' advice to be outside legal professional privilege and disclosable might impact the manner in which services are provided.

¹²⁵ The Law Society (2016) recognises this potential: "*Solicitors themselves may choose to shed the shackles of regulation and utilise their legal knowledge to work in or as unauthorised providers. It is not yet clear what the full implications of this possibility may be, apart from the fact that the individual will not be able to use the solicitor title or practise reserved activities under the current regulatory framework.*"

¹²⁶ See the Law Society (2016): "*Overall, we expect to see more solicitors exploiting the developments in the B2C market arising from competition between regulators, such as relinquishing official use of the solicitor title and setting themselves up as non-lawyer and/or unauthorised providers.*"

¹²⁷ The Law Society (2016) observes that risk is an area "*underserved by current market suppliers*" noting that: "*There are opportunities here for in-house counsel and law firms to develop offerings and advice around how companies handle risk, and manage their risk appetites.*"

Possible impact on regulated providers, including smaller providers

As discussed in section 3 above, wider changes in the legal services market are creating both challenges and opportunities for both regulated and alternative legal services providers of legal services.¹²⁸ It is important then that the possible impacts of the proposed changes be considered within this wider context, and having regard to differences in the size, location and specialisation of providers.

The proposed changes to the Handbook which are likely to have the most significant impacts on regulated providers are those which change the structure and content of the Handbook and allowing solicitors to deliver non reserved activities through an alternative legal services provider.

If effective, the proposed changes to the structure and content of the Handbook – particularly the changes involving a clearer distinction between individual and entity regulation, and the removal of duplicative and redundant requirements – should benefit regulated providers by reducing the complexity of the Handbook. It could also benefit regulated providers by removing overlapping or redundant regulatory requirements that currently apply to regulated firms. All of these changes might be expected to reduce the regulatory burden placed on regulated providers, which should reduce costs. However, as noted above in relation to solicitors, to the extent to which such changes are opaque or confusing, they might increase regulatory uncertainty. This could lead some regulated providers to either over- or under-comply with regulations, or seek out the services of third-party compliance experts. These measures could raise the costs associated with regulation, and reduce the ability of some providers to compete.

The ability of individual solicitors to deliver non reserved activities to the public by practising in an alternative legal services provider may have a number of possible impacts on (currently) regulated providers. First, it may have impacts in terms of attracting and retaining staff to work for them. Some solicitors may decide to deliver solely non reserved activities through an alternative legal services provider. Second, it could have impacts in terms of the ability to compete with some alternative legal services providers, particularly those which have strong consumer brand recognition. As the Law Society has recently noted, in the future regulated providers who do not offer the right services to consumers may be ‘bypassed’ as consumers seek out familiar brands.¹²⁹

As discussed above, the potential also exists that some currently regulated providers may choose to focus only on non reserved activities in the future, and therefore avoid the costs and obligations of entity level regulation. This could potentially place these

¹²⁸ As the Law Society (2016) has noted “*Changes to the legal services market bring both challenges and opportunities for those selling legal services. However, the opportunities for solicitors cannot be distinguished from the opportunities for other types of lawyer, or non-lawyer-owned businesses. Solicitors will need to be quick and act confidently to keep up with their competitors, be they peers or others.*”

¹²⁹ The Law Society (2016): “*Solicitor firms who fail to get offerings right for consumers may see these retail buyers bypass them to seek refuge in familiar brands.*”

providers at a competitive advantage *vis-à-vis* providers who do deliver reserved services and are therefore subject to regulation (including the costs associated with regulation). However, alongside the costs, there may be certain reputational and other benefits associated with being regulated (such as the availability of legal professional privilege), and this may act as a disincentive for some providers to 'opt-out' of regulation.

The potential impacts on regulated providers will differ according to their size, location and the types of advice and activities they provide. Around 48% of regulated entities are classified by the SRA as small providers, while a further 29% are classified as medium sized providers. According to the SRA, the majority of work undertaken by larger firms tends to involve non reserved activities, while for smaller firms approximately two-thirds of the work undertaken involves reserved activities. Table 6 details the distribution of firms according to various criteria.

Table 6: Distribution of regulated providers by size

	% of total	No. of firms	Basis of classification
Small	48%	5,150	Up to 4 partners/members/directors/ turnover < £400k
Medium	29%	3,112	Less turnover than top 1000 firms, but are not small
Large	8%	858	Next top 900 firms by turnover
Very large	1%	107	Top 100 firms by turnover
Other	14%	1,502	Include those not providing services
Total	100%	10,730	

Source: SRA.

It is generally acknowledged that larger providers, and those which target business customers, are likely to be best placed to adapt to changes in the legal services market.¹³⁰ They will also potentially be best equipped to adapt their activities to the changes being proposed by the SRA. Some of the more innovative providers may see this an opportunity to introduce new compliance and delivery methods. These larger providers already face competition from a range of international and specialist providers, as well as increasingly from ABSs such as large professional services and accounting firms, for non reserved activities.

The potential impact on smaller traditional regulated providers is more difficult to assess. Changes to the structure and content of the Handbook, and the refinement of the outcomes-focussed approach, have the potential to increase or decrease the burden and costs associated with complying with regulation depending on whether they increase clarity or create greater uncertainty. However, as discussed above, the ability of solicitors to deliver non reserved activities through a range of providers, may lead certain consumers to move away from smaller regulated providers to large

¹³⁰ This is consistent with a more general trend in terms of their ability to adapt to wider changes in the market. As the Law Society (2016) has noted more generally: “*Top 200/City firms and those corporate firms (large or specialist/niche) which serve business buyers appear better placed to weather storms in the service delivery climate.*”

alternative legal services providers who have a strong geographic presence (such as large retailers or other consumer-facing firms). The ability to deal with this competitive threat may be more limited for smaller, traditional providers as, for various reasons (such as their location) they may have to continue to deliver both reserved and non reserved activities.¹³¹ This issue is discussed in section 7.

Possible impact on firms who provide non reserved activities through non- solicitors

As discussed in section 3 above, some estimates suggest that the number of non-solicitors providing non reserved activities is in the vicinity of 130,000. These services range from general legal advice, corporate and commercial advice, housing advice, employment advice, to will writing and mediation services etc. Very little is known about the size and composition of the providers in which these non-solicitor advisors work. However, given the diversity in services provided, there is potentially a wide range of such providers in the market.

The proposed changes could potentially impact materially on these providers in two ways. First, and most obviously, current non-solicitor advisors working in such providers may in the future face more intense competition from solicitors working in alternative legal services providers. However, for the provider itself, the change may represent either a threat or an opportunity. Some providers may seek to recruit solicitors and therefore compete on this basis. Others may retain their existing business model and potentially face some competitive pressure from solicitors working in alternative legal services providers. To the extent to which consumers value the skills and expertise of solicitors working in alternative legal services providers, this could result in lower custom and revenues for providers who employ non-solicitors – i.e.: they may lose market share. However, there may be cost/pricing differentials between using a solicitor or non-solicitor advisor and, if so, providers who do not use solicitors will only lose custom to the extent that consumers consider any additional quality or consumer protection provided by dealing with a solicitor represents value for this price increment.

A second potential impact of the proposed changes is that some firms who recruit solicitors to deliver non reserved activities, may choose to become regulated by the SRA. That is, they may 'opt-in' to regulation. Although this would expose them to additional costs associated with regulatory obligations including mandatory insurance requirements, and compensation fund contributions, such regulation may have commercial value as a form of 'quality stamp' that differentiates such providers from some of their competitors and signals to the market that they offer additional protections. It may also have particular value if it ensures the availability of legal professional privilege for the services provided by their solicitors. The incentive to opt-in to regulation might be particularly attractive to cutting-edge or innovative providers who want to reassure consumers that they are subject to various controls and

¹³¹ More generally, it is acknowledged that smaller traditional private practice firms will find the competitive environment more challenging in the future. As the Law Society (2016) notes "*The harder transition will be for smaller traditional private practice firms, and it seems likely that existing firms will have fewer solicitors working in them in 2020.*"

processes, and that service users will be afforded traditional protections.

7. Specific questions relating to the changes

Drawing on the discussions throughout this paper, but particularly in section 6, this section addresses a set of key questions that have been identified by the SRA.

- i. What might be the effects of the proposed changes in terms of competition, costs for the consumer, choice and market growth?*

The specific potential impacts of the proposed changes on competition, consumer costs (i.e.: prices) and market expansion was considered in section 6 in detail. However, in brief, the main points to emerge from those discussions are as follows.

Competition

A key element of the proposals by the SRA is to remove what might be classed as an asymmetric regulatory restriction and therefore ‘level the playing field’ for solicitors and non-solicitors in relation to the provision of non reserved activities. The potential impact on competition of the removal of restrictions will depend on supply-side responses (i.e.: number of solicitors who deliver services through alternative legal services providers) and demand side responses (the extent to which consumers see the services as substitutes). Solicitors working for traditional regulated providers may find themselves facing more intense competition from solicitors providing non reserved activities through alternative legal services providers. Similarly, current non-solicitor advisors may face more intense competition in relation to some services from solicitors working in alternative legal services providers. To the extent to which allowing solicitors to practice within alternative legal services providers (including, familiar-brand providers) reduces consumer perceptions of elitism or intimidation associated with acquiring solicitor services from traditional law firms, or makes access to solicitors more convenient, this could, as discussed below, generate market growth in areas of unmet demand. However, the extent of competitive pressure exerted by alternative legal services providers will depend on the extent to which consumers are willing to forgo some traditional protections and rights they have enjoyed when obtaining legal services from a solicitor (for example, legal professional privilege).

Prices

The potential impacts of the proposed changes on costs to the consumer (i.e.: prices) are likely to differ according to the specific proposal, and critically, the extent to which any cost reductions experienced by providers are passed on to consumers. This, in turn, is dependent on the intensity of competition in the market. Proposals to simplify and restructure the Handbook and remove redundant and duplicative requirements should, other things being equal, reduce, or result in no material change, in costs and prices over the long term (although there may be transitional costs). The potential cost and price impacts of changes to refine the outcomes-focussed approach, will depend significantly on how this is implemented. As discussed, if solicitors and regulated providers take advantage of the greater flexibility afforded them to experiment and innovate this can potentially reduce the costs of compliance, and allow them to price

more competitively. On the other hand, if the changes are too imprecise or vague, and not accompanied by adequate guidance, this could increase costs and prices as those subject to regulation may commit resources, and implement processes, in excess of regulatory requirements or feel compelled to pay for advice as to what actions are in accordance with the principles/standards.

Proposals to develop public and business facing guides could improve consumer understanding of their rights and obligations, reduce search costs, and therefore allow them to place greater pricing pressure on existing providers. There may be some costs associated with the production of such guides though, although it is unclear how material the costs would be and who would bear the costs. Finally, the proposals to allow solicitors to deliver non reserved activities through alternative legal services providers might result in reduced prices for non reserved activities to the extent to which it intensifies competition in those activities. However, the ability of all providers to reduce prices may depend on the extent to which they deliver reserved and non reserved activities; solicitors who provide both activities, and remain subject to regulation, may not be able to price as competitively as providers of only non reserved activities.

Growth

In principle, the proposed changes could expand the market for legal services by removing restrictions that limit different business models and ways of doing things. As discussed, it could potentially lead to entry by new providers, including innovative providers, who can target their offers to specific customer segments using a range of delivery methods including by utilising new technology. It may also lead to entry by well-known retail brands, which could use their strong reputation to reach a wider segment of consumers. Some existing providers of legal services – such as charities and municipal bodies – may expand their activities to deliver non reserved activities directly to the public. Furthermore as discussed below, the ability of solicitors to use their skills and experience through a range of business models, could address concerns about unmet demand in the legal services market.

However, in some very specific circumstances, the proposed changes may not result in growth in the market, or could even lead to a contraction of the market in some areas. One possible scenario is if, as a result of the changes, consumers become more confused about the rights and protections that they have under different providers, and lose confidence in, and avoid, the legal services market. A second possible scenario is where, as a result of the changes, regulated providers in certain geographic locations – such as small, traditional providers – are subject to intense competition from new alternative legal services providers which makes their business models unsustainable. If these smaller regulated providers choose, or are compelled, to exit the market, this may result in some unmet demand for reserved legal services in those specific locations. Finally, growth in the alternative legal services provider sector may be limited if consumers prove unwilling to forgo certain traditional protections and rights they have enjoyed when obtaining legal services from a solicitor (e.g.: access to legal professional privilege).

ii. *How might the proposed changes improve access to legal services for the public and business users?*

As noted in earlier sections, there is a widely held view that there exists substantial unmet demand for legal services, particularly for individuals and smaller businesses. This unmet demand might, in turn, be impacting the access that some consumers of legal services have to justice.¹³² A key question is whether the proposed changes might address this issue.

The proposal to provide public and business facing guides should, if effective, increase consumer understanding of the legal services market, which could potentially result in more active and engaged consumers, and, in turn, expand access to legal services. Allowing solicitors to deliver non reserved activities through different types of providers may, as noted above, facilitate innovation in service delivery, creating more convenient, or lower cost, access points – for example, through retail outlets or via the Internet – and expand the market and reduce some unmet demand. Moreover, to the extent to which a significant number of providers seek to opt-in to regulation this could enhance the collective reputation of those involved in the delivery of non reserved legal services, potentially increase consumer confidence in these services, and reduce further the risk of unmet demand. However, if consumers are confused by, or suspicious of, the differing protections that apply to legal services depending on the entity through which a solicitor provides them, this may reduce consumer confidence in the market, and reduce access.

Finally, as noted above, if some current regulated providers, particularly smaller providers, exit the market, and such exit is concentrated in specific geographical locations or customer segments, this could potentially have impacts on consumer access to reserved services in those areas (and consequently ‘access to justice’ more generally).

iii. *In what circumstances might a consumer decide to choose a ‘qualified’ professional in an alternative legal services provider?*

As discussed in section 6, there are many types of ‘consumers’ of legal services, and the circumstances in which legal services are required can vary significantly. However, in general terms, the decision of a consumer to choose a solicitor working in an alternative legal services provider might be influenced by a various factors. First, consumers may appreciate the skills and expertise of solicitors in legal matters (which is warranted by their accreditation), and the fact that solicitors are bound by certain ethical obligations and professional responsibilities.

Second, consumers are likely to be influenced by price differentials between different

¹³² Although see Pleasence and Balmer (2014) who conclude that there is not a “*broad crisis of access to justice*” but that the “*legal services market and civil justice system do not ensure fair and equal access to justice, with deficiencies attributable largely to the difficulty of enabling vulnerable populations to access appropriate help.*”

service providers. If the price of a solicitor providing services in an alternative legal services provider is lower than that of a similarly qualified and skilled solicitor working in a regulated provider, this may be influential. As noted above, surveys indicate that cost of services is now considered to be the most important factor when searching for a provider, and providers who are not subject to legal services regulation are seen as having a perceived cost benefit. In addition, as noted, because alternative legal services providers will not incur some costs associated with regulation, this should lower their cost levels allowing them to compete more effectively on price. Nevertheless, in relation to the provision of certain types of legal services, consumers may be comparing the prices of solicitors with the price of non-solicitors offering similar services. In these circumstances, consumers may only prefer a solicitor where they perceive any increase in quality and protections available to be at least as valuable as the price differential. However, there is likely to be a portion of non reserved activities that are not typically dealt with by non-solicitors, and for which consumer choice will lie only between solicitors operating from regulated or alternative legal services providers.

A third reason why a consumer might choose the services of a solicitor working in an alternative legal services provider is that the provider utilises new and innovative delivery mechanisms. For example, if an alternative legal services provider better uses technology to reach consumers, or has a broader geographic scope of interfaces with consumers (for example, through a branch of retail outlets) than traditional regulated providers, or even ABSs. Consumers may also be influenced by a provider showing an enhanced understanding their needs and preferences. For example, an alternative legal services provider might offer higher levels of customer service, or different operating hours etc.¹³³

- iv. What are the best ways to support consumer confidence to make effective purchasing decisions as we open up the range of options for choosing and buying legal services?*

As emphasised throughout this paper, it is of central importance to the achievement of the desired regulatory objectives that the proposed changes do not increase consumer confusion, and are accompanied by measures which are educative in nature and seek to help consumers better understand differences in services and protections being offered. Combining educative and information measures with appropriate redress mechanisms might therefore best support consumer confidence. Put simply, consumers should be clear about the different protections and rights attached to different types of provider, and be confident that, should they not be satisfied with the service they receive, there is an acceptable means of seeking redress. This does not mean that consumers need to fully understand the detail of the regulatory architecture, but rather that they are aware of various signposts or signals that can guide them in their choice. This can include specific brands – such as the solicitor brand, or ‘SRA regulated’ – or the general reputation attached to major consumer brands.

¹³³ This is consistent with the general view that, given changes occurring in the market, solicitors reach out to help consumers clearly understand their issues and options, should do better. See the Law Society (2016).

In terms of consumer education and information measures, the proposals by the SRA to publish public facing guides should, if effective, support consumer understanding. Moreover, there are requirements that solicitors working in different types of providers disclose to consumers how they are regulated and what protections are available in relation to the services they provide. To be effective this may need to be accompanied by a policy of informed consent, whereby the consumer has to acknowledge that they have understood this. Having said this, informed consent policies can be meaningless if information is presented in a profuse or inaccessible way, and there may be some benefit in considering innovative presentational methods (e.g. the use of short videos, or simple diagrams or charts to set out relevant information and differences between different providers, rather than dense text). This may also need to be tailored to make such consent meaningful to particular groups of consumers, and to take account of different contexts in which such services are being sought.

Consumer confidence might be enhanced by an enforcement approach that rigorously disciplined failures of providers to disclose to consumers their rights and protections or misled them in this respect. As any such enforcement/disciplinary activity might be expected to have reputational consequences for the alternative legal services provider, vigilance in this area by the regulator may also provide commercial incentives for the provider to ensure their solicitors abide by their regulatory requirements.

v. What might be the impact of these proposals on vulnerable legal consumers?

The question of what constitutes a 'vulnerable' consumer is one that arises in a range of economic sectors. Research by consumer bodies has identified a range of conditions and circumstances which increase the risk of a person being, or becoming, vulnerable.¹³⁴ Moreover, it is increasingly emphasised that the concept of vulnerability is dynamic and multi-dimensional, and consumers can be vulnerable at different points in their life.¹³⁵

The Legal Services Consumer Panel has adopted a notion of vulnerability that encompasses individual risk factors that are particularly relevant to legal services.¹³⁶ Among the individual risk factors identified are: age, inexperience; learning or physical disabilities; location; lack of internet access; living alone; low literacy; low income; cultural barriers; health problems; relationship breakdown or release from prison. Although the exact number of consumers who might be classified as vulnerable is difficult to estimate, the SRA has found that around 10.6% of all turnover generated by regulated providers comes from work that is often associated with indicators of

¹³⁴ Among these: lack of self-confidence; low-literacy, numeracy and/or financial capability; low/insecure income; being unemployed; being a high-level carer of another person; having a physical impairment or mental health problems; living in social or public housing; and living in a lone parent household. See Consumer Focus (2012).

¹³⁵ An implication of this point is that consumer vulnerability can sometimes be a transient state, be triggered by events such as unemployment, the onset of mental illness, a temporary illness or disability or the becoming a carer. See Vulnerable Consumer Working Group (2013).

¹³⁶ They draw on the British Standard on Inclusive Service Provision. See Legal Services Consumer Panel (2014a).

vulnerability.¹³⁷

Clarity about what constitutes ‘vulnerability’, and the proxies used to identify vulnerable consumers, is however, important as it impacts on the choice between policies which are primarily targeted at issues associated with poverty (where consumers cannot afford certain services), and policies directed at a wider notion of vulnerability, which, as described above, encompasses a much wider set of consumers (those with health problems, or who may be IT illiterate etc.) and problems that certain groups of consumers might have in making effective and informed decisions in particular markets.

Of particular relevance to the current proposals is research that suggests that, in the legal services market, certain vulnerable consumers might face specific barriers to access such as physical (geography, disability), cultural (language) or service delivery (use of jargon).¹³⁸ Vulnerable consumers may also face additional barriers in complaining or seeking redress, and may be less willing to challenge a solicitor through a formal or official complaints process.

Having regard to these points, the proposals might, in principle, have positive impacts on vulnerable consumers in a number of ways. First, it introduces the possibility that vulnerable consumers who currently use non-solicitors for certain legal services could, in the future, have access to the skills and expertise of a solicitor working in an alternative legal services provider. These advisors are more qualified, and subject to specific controls in terms of ethics and accountability etc, including in identifying, and making adjustments when providing services to, consumers with particular needs and circumstances. The entry of these new providers does not come at the exclusion of existing providers, but rather introduces another supply option for vulnerable consumers. Second, new providers may aim at providing more accessible services to all consumers, including vulnerable consumers. In order to develop their share of the market, they may engage in outreach activities and seek to target specific customer groups that may have unmet legal demand or may be supplied by non-solicitors. Some solicitors may seek to address the issues of specific segments of the community (e.g.: certain ethnic groups) or interact with consumers through non-traditional access points (i.e.: at legal centers operated by charities, community groups etc.). Moreover, attempts to differentiate themselves might lead to innovative and customer-driven charging arrangements (e.g.: fixed fees etc.), different and more flexible trading hours (e.g.: weekends) or through different delivery mechanisms, such as taking advantage of unbundling to lower the costs to vulnerable consumers. Finally, to the extent to which some vulnerable consumers feel intimidated by traditional regulated providers – on the basis that they appear ‘elite’ – the entry of new providers, with different business models and approaches, including those with a reputation in other areas (such as retailing or charities) could make obtaining legal services seem less intimidating, and

¹³⁷ See Solicitors Regulation Authority (2015). The categories identified as being often associated with indicators of vulnerability are: family/matrimonial (3%), probate and estate administration (2.7%), bankruptcy/ insolvency (1.5%), children (1.4%), debt collection (0.8%), immigration (0.8%), mental health (0.2%), discrimination/ civil liberties/ human rights (0.1%) and social welfare (0.1%).

¹³⁸ See Legal Services Consumer Panel (2014a).

increase access to such services.

There are also some risks for some vulnerable consumers associated with the proposals. A general risk identified throughout this paper is that there is the potential for consumer confusion to be increased, insofar as consumers do not fully appreciate or understand that different level of protections apply when obtaining advice from solicitors in regulated and alternative legal services providers. This risk is potentially more acute for vulnerable consumers than it is for consumers generally. This is because, even if an individual solicitor working in an alternative legal services provider informs the consumer that they do not have the same protections, the consumer may not for reasons of vulnerability, appreciate or fully understand the consequences of this.

However, the extent of this risk arising needs to be considered relative to the current situation where research indicates that consumers are generally not aware of the difference between regulated and unauthorised providers of legal services and are surprised to learn that some legal services are not regulated.¹³⁹ Moreover, the Law Society has suggested that there are currently a proportion of non-practising solicitors who already provide advice through firms that are not regulated providers. Some of these practitioners might be telling consumers that they are qualified solicitors – effectively ‘trading on their brand’ – while not being regulated by the SRA. Put simply, the current situation is arguably also confusing for consumers,¹⁴⁰ and so the key question is whether the incremental change will be to clarify some of this confusion (by allowing solicitors to work in alternative legal services providers, and to fully disclose the regulatory status) or to further exacerbate the confusion for vulnerable consumers (by making the choice of provider more diverse).

Another potential, in-principle, risk is that intense competition by solicitors working in alternative legal services providers might encourage the over-provision of advice to vulnerable consumers. That is, vulnerable consumers might purchase the services of a solicitor working in an alternative legal services provider in circumstances where it was not needed, either because the issue could have been dealt with in a different way, or a non-solicitor advisor could have provided such advice at lower cost. Such over-provision of advice, particularly to vulnerable consumers, may in some circumstances be promoted by those who own or control the alternative legal services provider. However, while this is a potential risk, it may be mitigated by the requirement under the proposed solicitor’s code of conduct that solicitors take account of their client’s needs and circumstances, and do not take unfair advantage of their clients and others.

Finally, there is the question of the impact of the proposed changes on the ability and willingness of vulnerable consumers (and consumers more generally) to complain and seek redress. As noted, according to research there is currently confusion among

¹³⁹ See University of Leicester (2011).

¹⁴⁰ As the Law Society (2016) has noted; “*There remains a great deal of uncertainty amongst consumers about different types of lawyer and legal businesses. It is currently very difficult, even for knowledgeable consumers, to work out which provider is the most appropriate for their particular issue.*”

consumers about the difference between regulated and unauthorised providers and who they can apply to for redress.¹⁴¹ The proposed changes do not appear to materially reduce consumers' access to complaints mechanisms or information requirements in relation to available redress mechanisms. The proposed code of conduct for solicitors will require solicitors to establish and maintain, or participate in, a procedure for handling complaints, and must inform customers about the various redress mechanisms available to them. These obligations sit with the entity in the case of a regulated provider, so responsibilities are devolved to individual solicitors when working in alternative legal services providers. Individuals and SMEs will also continue to have access to the Legal Ombudsman Service to resolve complaints in relation to solicitors operating from alternative legal services providers.

- vi. *Will the proposed changes likely reduce the cost of delivering legal advice, and if so, are these cost reductions likely to be passed on to consumers?*

The possible cost impacts associated with the various specific proposed changes was discussed in detail in section 6.3 above.

As discussed in response to question (i) above, the likely extent of 'pass-through' of any cost reductions to consumer prices will depend on various factors, but most critically on the degree and intensity of competition. Where competition is weak, providers may be able to take any cost reductions as additional profit without fear that rivals will lower their prices (in response to the reduced costs) and attract custom. In contrast, if competition is effective, it might ordinarily be expected that some proportion of the reduced costs will be reflected in reduced prices, as providers seek to attract business away from their competitors.

- vii. *What are some of the possible impacts on regulatory compliance costs (transitional and ongoing) of simplifying the handbook and changing the approach to guidance for firms? Will they differ between different types and sizes of firm?*

The possible impacts on regulatory compliance costs associated with the specific proposed changes were also discussed in detail in section 6.3.

On the question of the relative distribution of these impacts among firms of different size, this will depend on various factors. The main change which could impact on compliance costs are those associated with changes to the structure and content of the Handbook and the refinement of the outcomes-focussed approach. As discussed, these changes, particularly the refinement of the outcomes-focussed approach, could either increase or decrease compliance costs for regulated providers *depending on how they are implemented*. On the one hand, if, as a result of the changes, regulated providers spend less time and resources on compliance, or take advantage of the greater flexibility afforded them in how they comply with a given principle/standard, this could lower compliance costs. On the other hand, if the proposed changes increase uncertainty because they are vague or imprecise, or are not fully understood, this could

¹⁴¹ See, generally, Northumbria University (2013).

result in both raised compliance costs and poorer regulatory outcomes.

Experience from other sectors indicates that medium and larger sized firms are best equipped to take advantage of the flexibility associated with more open regulatory strategies. Smaller firms, on the other hand, have less resources and capabilities and can find it difficult to understand what it means to 'be compliant' in a given set of circumstances. As discussed in section 4 above, this can lead them to unnecessarily avoid specific activities for fear they may be in breach of a particular regulatory principle/standard. In the current context, this potential impact on smaller providers may be mitigated by the proposal to introduce online guides and toolkits. Further specific measures might usefully be addressed at smaller providers, particularly those who are not IT literate. This could include a dedicated outreach team, and the introduction of case studies and toolkits targeted at smaller providers.

viii. How might allowing solicitors to work across an expanded legal services market improve the diversity of the profession? Is it possible to identify groups that will benefit and also those to whom the proposed changes will have a less apparent or non-existent effect on their careers and advancement?

As discussed in section 3, there is an increasing diversity in how legal services are being delivered, and how solicitors are working. An increasing number of solicitors are working in-house, as contractors or in various forms of non-traditional business structures. The general point is that solicitors are no longer only working in traditional professional service firms, but are working in a range of providers. The proposed changes may further contribute to this change by allowing solicitors the flexibility to work as a solicitor in the delivery of non reserved activities through a diverse set of alternative legal services providers.

This flexibility might, in turn, attract to the profession individuals who have a wide range of preferences and wish to work through alternative providers – i.e.: who were not attracted to the traditional provider model. The solicitors may, in turn, be in greater alignment with the diversity of the community, and better equipped to address the issues of specific segments of the community (e.g.: certain ethnic groups) or interact with consumers through non-traditional access points (i.e.: at legal centres operated by charities, community groups etc.). A greater range of potential providers through which solicitors can work might also attract solicitors who are attracted to organisational cultures more accustomed to flexible working arrangements – e.g.: on a part-time, or out of business hours basis.¹⁴² This might address concerns that some women do not take advantage of flexible working hours offered within traditional providers, because of fears that it may be harmful to their careers.

In terms of the possible impacts on different groups, the group that possibly stands to lose the most are current non-solicitors providing non reserved services in certain

¹⁴² It has been suggested that alternative providers might be particularly attractive to younger solicitors, who want to work in 'modern' organisations, have flexible working arrangements (e.g.: an ability to work from home), and who are not interested in the long-hours associated with traditional law firms.

areas (and the firms that employ them). Although the extent of the impact will depend on whether consumers value, and are prepared to pay for, the additional skills, quality and expertise of solicitors providing non reserved services as well as additional protections. The extent of this will also depend on how closely aligned the two types of service providers are in specific areas of advice. For example, the types of legal services currently provided by non-lawyers (e.g.: housing law advice etc) might be well provided by niche experts in the area rather than more generalist solicitors. Whereas solicitors working in alternative legal services providers may be more involved in the range of non reserved activities which non-solicitor providers do not tend to operate (e.g. transactional corporate advice and advice relating to risk).

For solicitors it might be argued that delivering non reserved activities through an alternative legal services provider will preclude the traditional career path open to solicitors within regulated providers – i.e. training contract, associate, associate, partner etc. However, it might equally be argued that such a career path is not an inevitable one and does not exist for solicitors working in very small regulated providers, or for the increasing proportion of solicitors who work in-house or as contractors. There is also some evidence to suggest that there are barriers to progression along this traditional career path for certain groups, such as women solicitors and Black, Asian and minority ethnic (BAME) solicitors. Moreover, as discussed in section 3, technological changes are increasingly eroding some of traditional law firms' more junior functions. Finally, solicitors working within alternative legal services providers will likely have their own potential career trajectory and to be able to advance internally within the provider (e.g.: to become head of the division etc.).

Nevertheless, a key implication of the proposals is that solicitors working in an alternative legal services provider will never, in their practice, be exposed to reserved activities. This lack of experience of wider areas of law, including reserved activities, could potentially limit the ability of these solicitors to advance their career in a regulated provider in the future. Of course, some solicitors working in an alternative legal services provider may not aspire to work in a regulated provider. Rather they may seek to develop a niche area of expertise in non reserved activities or to exploit some of the cross-disciplinary opportunities that working in an alternative legal services provider might allow. Further, many solicitors in regulated providers can end up working wholly outside reserved activities (after their training contract).

ix. Is there likely to be a geographic dimension to the impact of the changes?

The possible geographic impacts of the changes depend on a number of factors. First, and most obviously, it depends on where solicitors working in alternative legal services providers decide to establish a presence. They may, for example, decide to concentrate largely on urban areas, and not offer services in smaller rural areas. In these circumstances, the potential impact on consumers, and solicitors working in regulated providers in rural areas, may be minimal or non-existent, as consumers in those areas do not face any additional choice. Secondly, and related to the above point, the geographic impact will depend on the type of provider and the type of presence or delivery mechanism they employ. For example, if an alternative legal

services provider chooses to deliver non reserved activities largely via online means or through a telephone-based service then this could have national coverage. Similarly, if a large retailer with a national geographic footprint chooses to employ solicitors to offer non reserved activities the geographic reach of such service provision could be significant.

Depending on the scale and nature of entry by alternative legal services providers, it is possible that the impacts for consumers located in different parts of the country could be positive, neutral or negative. The impacts could be positive in circumstances where, as a result of the changes, consumers are offered additional supply options. For example, if in a specific town which has a regulated provider, an alternative legal services provider decides to establish itself and deliver non reserved activities. This potentially introduces some competition to the regulated provider, and can be beneficial to the consumer. In addition, if some solicitors working in alternative legal services providers deliver non reserved activities via the Internet or telephone services (i.e.: virtual law firms), then this can expand coverage to geographic locations where there may only be one physical regulated provider of legal services.

In contrast, as discussed elsewhere in this paper, there could potentially be negative impacts for consumers in circumstances where the entry by an alternative legal services provider undermines the financial sustainability of regulated providers who provide both reserved and non reserved activities in a specific geographic location. For example, if a large number of consumers choose to move away from the regulated provider for non reserved services and mainly use the online services of a solicitor employed by an alternative legal services provider (such as an Internet-based provider or a large retailer), this could make the regulated provider – such as a local High Street practice – unsustainable and result in closure. One effect of this is that consumers in that area will no longer have access to a local physical provider of reserved activities. However, the likelihood that this might occur depends on a number of factors. For example, it may be the case that, given the nature of services provided, some consumers continue to value face-to-face relationships with a known and regulated provider. In addition, the susceptibility of the regulated provider to closure will depend on the relative proportion of reserved and non reserved activities they undertake, as well as any niche expertise they may have that could give them a competitive edge against a more generalist provider.

More generally, it has been noted that although the changes could lead to the closure of some law practices, this does not mean that there will be less solicitors, and some of these solicitors may find employment in alternative legal services providers. That is, these solicitors will continue to provide legal services, but the provider through which they deliver such services may change.

- x. *Are there likely to be any negative or unintended consequences associated with the proposed changes?*

We have identified various risks, or possible unintended consequences, associated with the proposed changes throughout this paper. Among the most significant of these

are:

- That, as a result of simplification, the Handbook no longer adequately covers all of the complex circumstances that arise in practice, and that this may create gaps of coverage, which can impact on solicitors (in fulfilling regulatory objectives) and consumers (in benefiting from desired regulatory outcomes and protections).
- That some of the duplicative or apparently redundant requirements do, in fact, provide additional consumer protections over and above those contained in other legislation or regulations. If so, removal could result in consumers having fewer protections than under the current arrangements.
- That proposals to refine the outcomes-focussed regulatory strategy, particularly removing areas of prescription and the Indicative Behaviours, could create greater uncertainty for some of those subject to regulation as to how to comply with regulatory principles to meet regulatory objectives. This could result in over- or under-compliance, and increased costs and potentially foster growth in the third-party compliance industry.
- The development of public and business facing guides could be ineffective in practice, either because they are poorly targeted, or do not contain the right sorts of information that consumers and the public need.
- Allowing solicitors to deliver non reserved activities to the public, or section of the public, through alternative legal services providers raises a number of potential risks. First, certain protections afforded to consumers who use solicitors through regulated providers will not automatically be available to consumers utilising solicitors through alternative legal services providers. Second, consumers may be confused by the different consumer protections available under the different forms of legal service provision, reducing their confidence in the market. Third it could reduce the collective brand of 'solicitors', which could, in principle, have wider knock-on effects to the rest of the profession. Fourth, consumers may, for reasons associated with the loss of entity-level supervision, receive lower quality services from solicitors in alternative legal services providers. Fifth, it may – depending on a number of factors – lead to the exit of some current providers, particularly smaller providers, who may lose non reserved activities custom to larger alternative legal services providers to an extent that undermines their profitability. This could potentially have impacts on demand and access to justice if the exit of such providers is concentrated in certain geographical locations, such as those with only a single local provider of reserved services.

As discussed in this report, certain measures associated with implementation may be able to mitigate some of these risks. Among these: the development of targeted and effective guidance for solicitors which assists them in understanding how to comply with regulatory principles; ensuring that public facing guides and other materials are

used to meaningfully inform and educate consumers; and, potentially, the use of effective informed disclosure requirements for solicitors working in alternative legal services providers, to ensure that consumers are fully aware that they are 'opting-in' to a supply arrangement with different protections to those which exist for regulated providers.

Finally, and as discussed in section 4, the potential risks and unintended consequences associated with the proposed changes must be weighed against the potential benefits in terms of greater competition and innovation as well as the additional protections that will be available to consumers who currently use non-solicitors for non reserved legal services. Put simply, the relevant question is: are the potential risks for some consumers outweighed by the potentially significant gains for consumers generally?

- xi. Which legal services are likely to be most affected by the increased presence of solicitors being allowed the flexibility to provide legal services in a wider range of firms?*

According to various surveys, consumers are currently more likely to use a non-solicitor for advice relating to consumer law, debt and benefit problems, neighbour and employment disputes, and housing or tenant problems. However, this list should not necessarily be taken as indicative of the types of legal services that are likely to be most affected by the proposed changes. This is because the opportunity to access a solicitor outside a regulated provider to give advice on a wider range of areas has not existed for consumers. Put differently, some consumers may not have contemplated going to a non-solicitor for certain non reserved activities to date. So too, non-solicitor providers may have tended not to offer services in relation to some non reserved activities on the basis either they did not feel competent to provide these or that there was no market for the provision of these by non-solicitors.

It is possible to speculate that there are at least two areas of legal service which might be particularly affected by the proposed change. One area is the provision of commercial or corporate legal advice, particularly to small and medium sized firms. Notwithstanding the fact that legal problems are estimated to cause annual losses of £9.79 billion for SME's, it is claimed that there is a level of unmet demand for advice to SME's, with only 13% of SMEs regarding lawyers as cost effective. This suggests that SME's are reluctant to pay for the services of a regulated provider, and such consumers may be attracted to an alternative legal services provider if they price more competitively. In addition, some firms (such as firms of accountants) may choose to employ a solicitor and target SMEs to assist them in areas such as sales of businesses or commercial transactions, or in helping business to manage and handle their risk exposures and appetites. The potential scope for firms to offer such advice through solicitors may be significant.¹⁴³ According to the SRA, around 67% of all turnover generated by the firms they regulate comes from commercial or corporate work, and that this work does not necessarily involve a reserved legal activity.

¹⁴³ The Law Society (2016) sees risk advice as a growth area.

A second possible area that might be affected by the changes is the provision of legal advice to the public by solicitors working in membership organisations, charities and local authorities. The changes could broaden access for customer segments to utilise such services, and the legal press has reported existing demand by local authorities for such scope to use their in-house solicitors to provide services to other authorities and parties.¹⁴⁴

Finally, some firms who are not regulated providers consider the potential opportunities created by the changes are wide, and cover the 'full spectrum' of non reserved activities, and the provision of such services to individuals, households and small businesses.

¹⁴⁴ See Legal Futures (2016).

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