

Legal services market study: interim findings

LSB submission to the Competition and Market Authority's
Interim Findings Report

19 August 2016

Contents

Summary.....	3
Opening comments.....	3
Competition.....	4
Consumer protection.....	5
Regulation.....	7
Remedies.....	8

Summary

1. We agree with the CMA's analysis that a lack of transparency of price and service quality is undermining competition, reducing the incentives for providers to compete on price, quality and innovation. We would like to work with the CMA to help shape a set of transparency remedies that will truly be of benefit to consumers and that are practical and proportionate.
2. We are confident that transparency can be improved and consumers can become more empowered to drive competition. However, we think there are other inherent features of legal services which make it challenging to rely on consumers alone to actively shape the market. We think competition in legal services is limited not only due to a lack of transparency but also due to a weak consumer response more broadly, as a result of (for example) the infrequency of purchases and the prevalence of distress purchases. In addition, the legacy of strong professional identities in the sector fosters collective norms and behaviours within professional groups that can mute competition between providers. The current statutory framework for the regulation of legal services is not risk-based but is instead structured around professional groups and focused in part on professional titles, thereby embedding these cultural barriers to competition.
3. Our analysis, therefore, is that well-designed market transparency measures need to be progressed in tandem with regulatory reform (both short and long-term). Neither strand will be fully effective on its own; each can make an important difference. Flaws in the existing legislative framework contribute directly to reducing competition. The current structures reinforce the problems with lack of transparency and with cultural and behavioural norms which mean the market does not respond as effectively as it could to consumer need. While there are further steps that can and are being taken to make the best of the current framework, we are convinced that major legislative reform is needed to secure longer term benefits to competition and the wider public interest.

Opening comments

4. We welcome the CMA's interim findings report (the Interim Findings Report). It provides a cogent analysis of the legal services markets, their strengths and weaknesses, and proposals as to how the markets need to work better for consumers. The findings are consistent with evidence contained in our major triennial Market Evaluation report¹. Overall, we consider there have been positive developments since the Legal Services Act 2007 (the Act), with quality maintained or even improved while the market has been significantly reformed. However, our analysis also reveals the continued scale of unmet need and suggests there needs to be more progress towards delivering better market outcomes. In addition, the pace of change needs to increase.

¹ LSB, [Evaluation: Changes in the legal services market 2006/07-2014/15](#), July 2016.

5. The Interim Findings Report explores a wide range of possible regulatory and other interventions designed to increase competition. The LSB considers it can best contribute at this stage by offering some high-level observations on the CMA's diagnosis and early thinking on remedies including suggesting some areas where the CMA may be able to expand its analysis as it works towards its final report. As the CMA develops its proposals in the coming months, we will continue to share our analysis and evidence from our unique position as the oversight regulator of legal services in England and Wales.
6. The CMA's analysis is soundly based on research and other market information. We are pleased to have contributed much of this source material. We believe that the sector needs more research and we are encouraging the legal services regulators and other stakeholders to fill the gaps in the evidence base to allow effective policy making. Any remedies need to be evidence based and take account of empirical evidence on behavioural biases. Where possible they should be tested with consumers and be subject to cost benefit analysis to ensure they are proportionate.
7. We have structured the remainder of our response around the core issues identified by the CMA: competition, consumer protection, regulation and remedies.

Competition

8. We agree with the CMA's analysis that a lack of transparency of price and service quality is undermining competition, reducing the incentives for providers to compete on price, quality and innovation. We have for a long time championed the need for greater transparency in the market. We have, for example, worked alongside others to facilitate the emergence of Digital Comparison Tools (DCTs) to aid consumer choice. We consider, however, that the reasons that competition is not as effective as it could be (and therefore that consumers are not benefiting to the extent they should from competition) go wider than this, as set out in the following paragraphs.
9. Paragraph 4.1 of the Interim Findings Report states that the legal services market is highly fragmented. However, the Interim Findings Report also notes at paragraph 4.4 that competition often takes place locally. The number of providers may be limited in certain local areas, making the market concentrated in those areas. The importance of this will vary by area of law depending on whether services tend to be delivered face-to-face or remotely².
10. In addition, when looked at in terms of professional groups (for the sake of argument: solicitors, barristers, other professionals and unregulated providers), the market would not seem to be fragmented. For example, the CMA's survey found that 77% of conveyancing advice, 78% of will-writing advice and 84% of probate/estate management advice was provided by solicitors (see paragraph 3.29 of the Interim Findings Report) and the LSB's Market Evaluation report

² The LSB's individual legal needs survey suggests that face-to-face is the main channel of communication with the provider in 40% of issues where respondents received advice.

found that in 2015, solicitors had 58% of the UK legal sector market by turnover and barristers had 9%. These professional groups by their nature have a tendency towards shared cultural norms which can have some benefits, but which also lead to behaviours that mute competition between providers. The Interim Findings Report includes a series of examples of such behaviours, for example:

- ‘solicitor’ rather than firm branding appears to be prevalent³
- there appears to be some cultural resistance to moving across professional boundaries⁴ and to the use of online reviews⁵
- cost-plus pricing⁶ is common ie charging by the hour⁷.

11. Clearly there are no dominant companies within the markets in focus so we do not consider these are concentrated overall. Rather, in some circumstances and for some of the time, these shared cultural norms act to weaken competition. The CMA may wish to give further thought to this issue. As we explore further below, the statutory framework for the regulation of legal services is structured around professional groups and is focused in part on professional titles, thereby embedding this problem. In our view it will be difficult to effect a change in cultural norms and create a stronger competitive impulse amongst a greater number of providers without also reforming the statutory framework.

Consumer protection

12. The CMA’s conclusions on the unregulated market align with our own findings⁸. While there is a lack of evidence of consumer detriment, we agree there is a need to improve consumer awareness of the regulatory status of providers and the resulting differences in levels of protection so that consumers can make informed choices. Consumer awareness about the regulatory status of *all* providers may improve if it is as clear as it could be whether a provider *is* regulated. While regulated providers can be required to make their regulatory

³ The Interim Findings Report notes that there were submissions that there is a lack of investment historically in advertising and marketing in the legal sector (paragraph 4.30) and that ‘solicitor’ and ‘barrister’ are indicators of quality that can be easily understood by consumers (paragraph 4.32). The CMA’s qualitative survey also found that individuals and small businesses are typically familiar with solicitors but much less aware of alternative unregulated providers (paragraph 4.51).

⁴ For example, the research jointly commissioned by the LSB and the Bar Standards Board into barristers’ perceptions of the public access scheme found that, while barristers acknowledged that conducting litigation was a critical means of improving accessibility of legal services to consumers, only a small proportion of public access barristers had so far obtained authorisation to do so. Those reluctant to conduct litigation cited the additional administrative burden and a perception of more “hand-holding” of clients as the main barriers. They stated that clients could have unrealistic expectations of the role of the barrister, which could result in what they considered to be “excessive” correspondence and administration. See <https://research.legalservicesboard.org.uk/wp-content/media/Public-Access-FINAL-Report.pdf>

⁵ See paragraphs 4.29, 4.46 and 7.37 of the Interim Findings Report.

⁶ Cost-plus pricing means that firms set a price by calculating average production costs and then adding a margin to achieve a desired profit level.

⁷ Risk-averse attitudes to pricing are also reflected in evidence in the Interim Findings Report (see for example paragraphs 4.17, 4.22 and 4.46).

⁸ See the section of our [website](#) summarising our work on unregulated providers.

status clear, it is harder to identify ways in which the status of unregulated providers can be made clear.

13. Encouraging advice agencies and other organisations that provide basic consumer information about legal services to take a 'whole market' approach (so that their information covers both regulated and unregulated providers) would help to improve consumer knowledge of and confidence in unregulated providers. In addition, we consider regulators' statutory duty to have regard to the regulatory objectives, for example improving access to justice and promoting competition, means that it is essential for them to take into account both regulated and unregulated service providers in their work. As well as the Legal Choices website which is run by the regulators, major economy-wide consumer information providers, such as Citizens Advice, have an important role.
14. We note the CMA's view on unregulated will-writers (see paragraph 5.12 onwards of the Interim Findings Report). However, we consider that consumers do face material risks when using such providers based on the evidence and analysis in our investigation into will-writing in 2011. The unique feature of this market is that defective wills may not be spotted until the testator is deceased. Our recent research mapping the unregulated sector was primarily a supply side analysis and was not intended to assess levels of consumer detriment. In particular, the quality of wills – the key risk identified in our 2011 investigation – was not assessed. Therefore, our recent research mapping the unregulated sector should not be seen as undermining our previous conclusion that will-writing should be reserved, although it did not suggest the immediate need for a new investigation.
15. The Interim Findings Report (paragraph 5.61) states that the CMA's initial findings do not suggest that the handling of complaints raises significant problems, but there may be some improvements that could be made to encourage more consumers to raise complaints if they are dissatisfied and to ensure that complaints are handled well. There is some evidence of improving provider performance on complaints-handling. Fewer dissatisfied consumers take no action⁹, a lower proportion of complaints are escalated to the Legal Ombudsman¹⁰, and a higher proportion of consumers using the Legal Ombudsman recall being signposted to it by their provider¹¹. However, the LSB wishes to see outcomes for consumers improve still further, including more dissatisfied consumers having the confidence to complain should they wish to. Given barriers to complaining and the issue of 'referral fatigue'¹² it is not satisfactory for consumers to face problems navigating their way through the system even if they may reach the right destination in the end. We have recently

⁹ The [LSCP Tracker Survey](#) recorded the percentage of dissatisfied consumers who did nothing as 44% in 2014, 42% in 2015 and 35% in 2016.

¹⁰ LSB, [Evaluation: Changes in the legal services market 2006/07-2014/15](#), July 2016 - see pages 123-4.

¹¹ [Consultation on updates to rules made under section 112 of the Legal Services Act 2007, March 2016](#). The figures were 17% in 2011/12, 19% in 2012/13 and 23% in 2013/14.

¹² Where people face an elongated hunt for advice due to inadequate signposting.

updated our rules and guidance on first-tier complaints handling¹³ and will be monitoring the impact of the effect of regulatory intervention.

Regulation

16. As the CMA notes at paragraphs 3.4 and 3.5 of the Interim Findings Report, sector-specific regulation of legal services is necessary for several reasons. These include the information asymmetries between consumer and provider, the existence of externalities¹⁴ and the public interest outcomes that must be secured (such as the rule of law and the effective administration of justice). In analysing the impact of regulation on competition, it is important that regulation is not considered purely to be driven by the need for consumer protection.
17. We welcome the CMA's recognition of the work completed by the LSB and approved regulators to make regulation more proportionate. Independent analysis of 195 applications that were made in 2010-15 by approved regulators to make changes to their regulatory arrangements and that were processed by LSB found that the likely cumulative market impact was by and large pro-competitive and that these changes can be expected to have acted as drivers for pro-competitive changes in the market¹⁵.
18. Working with the legal services regulators, the LSB has looked for other opportunities for minor clausal changes to the Act that would remove unnecessary restrictions on providers¹⁶.
19. Looking at the statutory framework for regulation more broadly, we believe that it reinforces cultural norms in professional groups that act to weaken competition for the reasons set out in paragraphs [8] to [11]. We therefore think that the impact on competition of key elements of the statutory framework (such as the reserved activities, regulation by title and the complexity of the regulatory structure) need to be assessed in this light.
20. Although improvements to the existing regulatory framework to encourage more competition can still be made, we consider the scope for progress may be limited when professional titles and the reserved activities remain the key building blocks underpinning the current arrangements. The lack of full independence between regulators and representative bodies and the multiplicity of regulatory bodies (one for each professional group) are other competition limiting features also 'locked in' by the Act. Only incremental changes can be made to address these issues without significant legislative reform.

¹³ LSB, [Changes to requirements made under section 112 and guidance made under section 162 of the Legal Services Act 2007. LSB decision document on changes to first-tier complaints handling and guidance for approved regulators](#), July 2016.

¹⁴ An externality arises when a transaction benefits or harms parties beyond the provider and purchaser of a good or service.

¹⁵ Piotr Jasiński and Suzanne Rab, [Economic Advice on Likely Market Impacts of Changes to Regulation 2010-2015](#), Oxford Economics, July 2016.

¹⁶ The Ministry of Justice is [consulting](#) on amendments to Schedules 11 and 13, repeal of section 85(5)(b) and amendments to sections 91(1)(b) and 92(2). See our [response](#).

21. The potential to increase competition under the Act also needs to take account of the other sector-specific legislation with which it coexists such as the Solicitors Act 1974 and the Administration of Justice Act 1985. These statutes should be part of the CMA's analysis of the impact of regulation on competition in order fully to understand the interplay of activity and title-based regulation. We believe that it is not just a question of how much flexibility the Act gives regulators (see paragraph 7.67 of the Interim Findings Report) but how much flexibility the entire legislative regime permits.

Remedies

22. Overall, while we are confident that transparency can be improved and consumers can become more empowered to drive competition, it is important to take account of other inherent features of the market – the infrequency of legal need, distress purchases and desire for personal recommendation due to the emotional context of some legal services – which make it challenging to rely on consumers alone to actively shape the market.

23. This is because we think that competition is limited due to:

- lack of transparency *and* weak consumer response, which interact with
- the legacy of strong professional identities (supported by regulation which is not risk-based but is instead structured around professional groups and focused in part on professional titles). This in turn fosters collective norms and behaviours within professional groups.

24. Hence there should be a package of remedies that seeks to both unlock consumer power through increased transparency and harness regulatory reform to unleash innovation and foster a more consumer-responsive culture amongst providers.

Transparency remedies

25. While we agree with the CMA that increased transparency is desirable, there is ongoing debate around what information can and should be made available to consumers (and DCTs). The Legal Services Consumer Panel (LSCP) has advanced the debate¹⁷, and we have set out early views of our own¹⁸.

26. We would like to work with the CMA to help shape a set of transparency remedies that will truly be of benefit to consumers and that are practical and proportionate. Challenges will include delivering remedies that:

- are capable of practical implementation given the diverse provider base, complexity and range of services, and variation in pricing models
- deliver savings for consumers that outweigh any implementation and increased compliance costs for providers

¹⁷ [LSCP, Opening up data in legal services, February 2016.](#)

¹⁸ [LSB letter responding to the LSCP's advice, 26 April 2016.](#)

- do not have unintended consequences, such as reduced variety of services¹⁹ or increased prices²⁰
- are effective given insights from behavioural economics²¹
- are enforceable.

27. As signalled in our 2016/17 Business Plan we have recently asked the LSCP “to provide advice on the effectiveness of current information remedies in legal services regulation and how these could be improved”²². We have asked the LSCP to report by the end of 2016 and we expect their advice to be timely in light of the range of information remedies currently being considered by the CMA and the approved regulators’ work in this area²³.

28. We support the need to address barriers to comparison and search. The apparent cultural barriers to participation by providers in DCTs are of concern. Increased transparency of price and service should help to remove these barriers, however our discussions with cross-economy DCT providers (and our own analysis) indicate that embedded features of the market are also factors. These features include a fragmented supplier base, lack of standardisation of fees and charging structures, lack of standardised services in some cases, and low technological sophistication in providers’ websites. While market conditions may become more suitable over time and investment has recently supported entry by legal sector focused DCTs, at present the legal services market is not seen by existing economy-wide DCTs as a priority growth area.

Consumer protection remedies

29. We agree with the CMA that the title of ‘lawyer’ should not become protected by statute (see paragraph 7.50). As well as the economic arguments advanced by the CMA, experience elsewhere has shown that it is easy for providers simply to switch to a new title every time one is protected. Further, we wholly support the CMA’s desire to see a shift in emphasis away from regulation by professional title. We believe that regulation by professional title works against risk-based regulation and is increasingly outdated as distinctions based on titles and types of provider are becoming blurred in the modern market place. It could also have an adverse effect on competition by acting to support certain shared cultural norms within professional groups (see above).

¹⁹ For example if a requirement to publish prices leads some providers to stop offering fixed fees because they believe it will require them to reduce their prices.

²⁰ For example, in other markets where regulators have required providers to simplify tariffs or not to discriminate between consumers, this appears to have inadvertently led to higher prices. While those other markets may have been concentrated, we believe that (as noted above) the degree of fragmentation of the legal services market does not fully reflect the tendency towards collective norms and behaviours in the market. As also noted above, cost-plus pricing is common in legal services which suggests particular care is required around price transparency as there may be a risk of price following.

²¹ Relevant insights include status quo bias, the importance of how information is presented and the impact of choice overload. See also Linstock Communications, [Understanding decision making in legal services: lessons from behavioural economics](#), LSB, June 2013 and Citizens Advice [Applying behavioural insights to regulated markets](#).

²² The LSB’s [letter](#) commissioning the advice was sent on 16 August.

²³ This includes the collaborative work on client care letters and the SRA’s consultation on a revised Handbook.

30. We will consider further the question raised by the CMA as to whether the Legal Ombudsman's jurisdiction should be widened to include businesses other than micro-businesses and third parties. With respect to the ADR Regulations, while regulated providers are required under rules made by the LSB to signpost consumers to the Legal Ombudsman, confusion may arise because they must additionally signpost to an ADR body approved by the Chartered Trading Standards Institute. We informed approved regulators and representative bodies to notify practitioners about this issue when the ADR Regulations came into effect, but ensuring compliance with this prevailing legislation is the responsibility of local authority regulatory services. While standard guidance (see paragraph 7.58 of the Interim Findings Report) may have benefits, it would not resolve the inherently confusing situation that the Directive underpinning the Regulations has created.

Regulation remedies

31. We consider there is a strong case for wholesale reform to the legislative framework because flaws in it contribute directly to reduced competition as well as having a broader adverse impact on the public interest. These flaws are well-rehearsed and were set out in a document submitted to Ministers following cross-regulator discussions in July 2015²⁴. These flaws are not matters that can solely be addressed by the provision of better consumer information. The current framework is not properly risk-based. There are blanket consumer protections in some areas that unnecessarily increase costs for providers that are then passed on to consumers, while some potentially high-risk activities fall beyond the reach of regulation. Ongoing links between professional bodies and regulators slow the pace of reforms that would otherwise free up providers of legal services to innovate and grow. This lack of independent regulation also increases the costs faced by providers and acts to undermine public confidence in regulation.

32. We will set out our vision for reform in shortly, which will address each of the key issues identified in the July 2015 paper²⁵. In the meantime we welcome many of the initial conclusions reached by the CMA to date, including: concern about the complexity of the current system with its nine approved regulators; support for the principle of full regulatory independence; recognition of the possible merits of conducting a systematic review of which legal services or activities should be regulated and how; and support for reducing the emphasis on regulatory titles. The CMA's openness to considering these issues further is welcome.

33. In November 2015, HM Treasury announced in its competition plan²⁶ that the Government would consult on making legal service regulators independent from their representative bodies. Given the significant developments since then, and the possible impact of those developments on government priorities, we think it would be helpful if the CMA made an explicit recommendation in its Final Report

²⁴ [Legislative options beyond the Legal Services Act 2007](#), July 2015.

²⁵ The July 2015 paper identified six issues that need to be considered in the design of any future regulatory framework: regulatory objectives; scope of regulation; focus of regulation; regulatory independence; consumer voice; and institutional architecture.

²⁶ HM Treasury, A better deal: boosting competition to bring down bills for families and firms, November 2015

that the planned consultation should proceed, should such a recommendation still be relevant at that time. Full regulatory independence would be a very important development, although the need for structural reform extends beyond independence issues.

34. We are, of course, mindful that there will inevitably be some challenges with the transition to a new regulatory framework. The key consideration is whether the expected long-term benefits of change are likely to outweigh any transitional costs. We believe this will prove to be the case.

35. We will continue to make the most of the current legislative framework through ongoing work to break down regulatory barriers and tackle unmet need. Ultimately, though, we think the current legislative model is not sustainable in the long term and believe that structural reform, in conjunction with transparency measures, are both necessary steps to deliver better consumer outcomes. Reform will take time to deliver, so we are keen for the process to start soon.