

## Consumer risk in legal services

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A report for the Solicitors Regulation Authority

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4 December 2017

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### Executive Summary

Economics, Policy and Competition (EPC) has been commissioned by the Solicitors Regulation Authority (SRA) to examine issues of consumer risk in legal services, particularly those that might arise in relation to changing professional indemnity insurance (PII) requirements.

The SRA intends to consult on various issues surrounding the minimum terms and conditions for PII and in this context the Legal Services Consumer Panel (LSCP) suggested research is required to take into account the need to be realistic about the financial risks consumers can reasonably be expected to understand and manage. In addition, the Competition and Markets Authority (CMA) has called for legal services regulators to set a new minimum standard for the information that is published by firms and the SRA intends to conduct consumer testing to help to develop this.

Financial risks for consumers arise because of poor value for money and exclusion as well as because of negligent advice. Hence it is important that when considering financial risk, the SRA examine this in a wide sense, recognising that this covers more risks than those for which PII is designed to provide redress.

When examining redress and the changes to PII that the SRA is considering, this is aimed at reducing financial risks to consumers as a whole. If the reforms are more proportionate, then better value for money would result both from the direct effect of reduced regulatory costs leading to lower prices but also from the greater competition arising from lower barriers to entry and supply side flexibility. As such this would reduce the financial risks to consumers as a whole by bringing better value for money and also by bringing consumers into the regulated market who are currently just priced out of it. These effects rest on improvements on the supply side rather than consumers taking more action on the demand side.

However, it is also clear that the impact of changing PII conditions is not only one that is felt by the average and potential consumer (through lower prices of their legal services) but is also one that is felt by a small number of consumers who may no longer receive the same level of protection as they do currently. For these particular consumers, the detrimental financial impact of lower PII cover could be severe.

Information on redress can bring a market confidence role as well as being clearly designed to ensure that consumers do receive redress when things go wrong. The report highlights different options for disclosure that can be compared to identify information that is most effective, the time in the process at which consumers would value this information and whether highlighting that these are regulatory requirements bring additional impacts.

Information provision can help consumers to understand the risks they face and to mitigate these risks by changing their purchasing decisions. In practice, existing evidence shows that even those consumers who do shop around are much less likely to search on the basis of redress than other factors such as price and quality of service; the underlying reason for this could be determined through consumer testing.

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Information on PII limits could be provided to consumers, but the level of information that they would require to make fully informed decisions is complex, particularly if they were expected to trade-off this information against price. Regulators therefore need to be realistic about the extent to which consumers will understand and respond to information given this complexity and the potential for information overload.

Simple information on PII could be conveyed, and the report highlights some possible options for this. An important element of the testing is to assess not only the impact of the information on redress but also to consider the consequential impact on other information provided at the same time. If, for example, consumers are constrained in the amount of time or effort that they spend looking at information then it is important that this is directed at areas that will generate the greatest benefit in terms of financial risks as a whole.

Finally, it may be the case that it is not appropriate to use information to help consumers to mitigate the risk that PII limits could be insufficient. The SRA could require firms to ensure this is not the case although this may be disproportionate for high value consumer transactions given the small risks; or the SRA itself could provide alternative protection. Alternatively, the SRA may judge that the severe impacts that might result for a few consumers for whom mitigation is not realistic is a necessary trade-off for the greater benefits for consumers as a whole.

### 1 Introduction

Economics, Policy and Competition (EPC) has been commissioned by the Solicitors Regulation Authority (SRA) to examine issues of consumer risk in legal services, particularly those that might arise in relation to changing professional indemnity insurance (PII) requirements.

#### 1.1 Background

The SRA intends to consult on various issues surrounding the minimum terms and conditions for PII. In the context of this, the Legal Services Consumer Panel (LSCP) have raised questions about whether sufficient consumer research has occurred to know the extent to which consumers understand and are able to bear financial risk within legal services. The LSCP suggest research is required so that the SRA is able to strike the right balance between different stakeholders in the PII arrangements. The LSCP suggest such balance involves the SRA taking into account that some consumers lack experience in dealing with legal issues and the need to be realistic about the risks consumers can reasonably be expected to understand and manage.

In addition to this, the Competition and Markets Authority (CMA) has called for legal services regulators to set a new minimum standard for the information that is published by firms. The SRA therefore plans to undertake research starting later this year to:

- explore the information the SRA should ask firms to publish (focusing on complaints, protections, quality and redress) to help consumers make good choices when purchasing legal services;
- test how the presentation of this information impacts the decisions consumers make. This will include the potential use of logos to explain what protections are in place when using a regulated firm; and
- identify the barriers that are currently stopping firms from publishing information on complaints, protections, quality and redress.

The research on the minimum standard for information is not yet fully scoped and therefore part of the aim of the current paper is to help to inform the scoping of the future project. The rest of the report is structured as follows:

- Chapter 2 briefly examines the different types of risk that consumers can face in legal services noting the financial risks that arise from having poor value for money as well as those risks that arise because something goes wrong in the provision of legal advice;<sup>1</sup>
- Chapter 3 considers the role of information provision generally, where this can be beneficial, and some of the weaknesses of relying on information provision that are particularly pertinent to the other issues covered in this report;
- Chapter 4 examines the issue of redress including evidence from other regulators who have sought to limit the financial risks that consumers face and the role of redress mechanisms covering consumer protection and driving competition. Information is set out that could in

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<sup>1</sup> All references to consumers should be taken as reference to individual consumers rather than incorporating other users of legal services unless otherwise specified.

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theory help consumers to mitigate the risk from insufficient PII and it is identified where the limitations highlighted in Chapter 3 have particular relevance; and

- Chapter 5 examines the implications for where consumer testing could help to establish further evidence on these issues and suggests specific issues for testing.

### 2 Risks to consumers of legal services

Consumers face a whole raft of different types of risk in everyday life from the food we eat, the mode of transport we travel in, and the products that we use. Governments and regulators use a multitude of different requirements, many of which consumers are unaware of, when seeking to limit the detrimental consequences of these risks. These include requiring or banning certain products or processes, licensing approved firms, imposing product standards and information requirements. Whether the risk merits intervention, the appropriate response and the trade-off between different types of response to different types of risk varies substantially according to the specific nature and context of the risk.

This chapter briefly considers the different types of risk that can arise in legal services. The focus of the rest of the report is on information provision (considered in more detail in Chapter 3) and issues to do with redress (considered in more detail in Chapter 4). For example, the paper does not consider whether the SRA's authorisation requirements or educational requirements are appropriate even though such requirements clearly impact on the extent to which consumer detriment might arise from different sources of risk.

#### 2.1 Risk in legal services

Legal services cover a range of areas including different types of law which, even for individual consumers can cover issues as wide as criminal cases, conveyancing, employment, family law, immigration, medical negligence, personal injury, and wills and probate. Some aspects of these areas fall into the category of reserved services which only regulated firms and individuals can offer whereas other aspects of legal services could be provided by non-regulated firms or individuals. The nature of risks associated to poor or negligent quality advice might vary from more jail time, loss of custody of children, failure to register the title of a property, or disputes surrounding a will. Hence the impacts on consumers are not necessarily always felt in purely financial terms even though redress mechanisms might provide compensation in financial terms.

The quality of legal services from the consumer perspective depends not only on the technical legal advice itself, but also service factors such as how and when firms communicate with their clients. Therefore consumers could be exposed to risks associated to whether they receive advice from the named lawyer they expected, communications not being received at an expected frequency, or the advice not starting or being completed when expected.

Hence although there is considerable variety in legal services and the precise risks that consumers face, for the purpose of this work, it is useful to think of the risks to consumers as broadly falling into a number of different generic categories including:

- Receiving poor value advice or service – because of high prices or low quality;
- Receiving advice that goes wrong and the associated impact of this – because of negligence or dishonesty;<sup>2</sup> and

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<sup>2</sup> There is a spectrum in low quality advice (including low quality service) since some advice can be of low quality but not necessarily negligent. Given the focus on redress in this report it is useful to distinguish the negligent advice from advice that is simply low quality and would not involve recourse to PII policies.

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- Receiving no advice – because of being excluded from the market.

The risk of poor value advice can occur not only because the price might be cheaper at an alternative provider, but also if the price turns out to be very different from that which the consumer expected. Evidence from Australia on the extent of such price shock found that 22% of consumers of legal services stated that their fees had been more than the estimate with 17% of these stating that this would make them less likely to use legal services in the future.<sup>3</sup>

It is also worth pausing on the concern that some consumers may receive no regulated legal advice and so face detrimental consequences including financial losses due to having to deal with the legal issue unadvised. For example, consumers may end up dealing with complex criminal, employment or personal injury claims without an expert adviser and therefore end up with a significantly worse outcome than had they received advice. In general, regulators are responsible for the actions within their regulatory remit rather than what happens outside this. However, given the importance of access to justice, it is appropriate for the SRA and other legal regulators to be concerned about regulation which might lead to some consumers being excluded from regulated legal services.<sup>4</sup>

### 2.2 Regulation to reduce risk in legal services

Within legal services there are many difficulties for consumers in choosing appropriate legal services provision to do with asymmetric information, distress purchasing, and the credence nature of legal services (where the quality of advice is not known in advance, and indeed may not even be known after advice has been received). These issues make the assessment of risks hard for consumers to judge; hence regulators are in place to help reduce risk. Regulation by the SRA, and other legal services regulators, aims to address some of the risks listed above and, as with the risks themselves, there are a variety of different ways in which regulation can bring benefits to consumers and a variety of different forms of regulation including:

- Initial requirements on individuals or firms that can participate in the regulated market such as various educational and training requirements for individual lawyers pre or post qualification or the authorisation of firms;
- Standards regarding the delivery of advice such as requirements to do with information disclosure including in relation to the price of services and/or the basis of their calculation or how the case will be handled, requirements to uphold the law whilst delivering advice, as well as requirements related to the financial stability of a firm; and
- Requirements related to redress mechanism including complaint mechanisms, the need to hold professional indemnity insurance (PII), the provision of the Compensation Fund and the presence and funding of the Legal Ombudsman.

Already it is clear that there are trade-offs to be made in regulation. For example, there is a balance to be struck between regulators seeking to prevent risks from arising by imposing regulation in advance compared to reducing the impact of any crystallised risks through redress mechanisms.

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<sup>3</sup> Australian Legal Services Council, Consumer Survey 2017.

<sup>4</sup> Similar issues are faced by other regulators such as with respect to financial exclusion and utilities with universal service obligations.



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Regulators of different professional services do not aim for a regime in which advice never goes wrong since the cost of achieving such a regime would be vastly greater than the cost of providing redress.<sup>5</sup>

Broadly, these different types of regulation aim at reducing the extent to which advice is poor value and the extent and impact of advice that goes wrong. However, the consequences of such regulation can also be to adversely restrict the way firms deliver services, cause unintended consequences, and to impose costs. This latter effect not only raises prices for consumers who participate in the regulated part of the legal services market but potentially also reduces the size of that market by excluding consumers due to these high prices.

### 2.3 Summary

Although the context of the report is the SRA considering changes to PII requirements, financial risks arise for consumers because of poor value for money and exclusion as well as because of negligent advice. Hence it is important that when considering financial risk, the SRA examine this in a wide sense, recognising that this covers more risks than those for which PII is designed to provide redress. While regulation as a whole aims to reduce risk, excessive regulation could end up simply imposing costs which itself can exacerbate the detrimental financial consequences for consumers in respect of poor value and exclusion.

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<sup>5</sup> If regulators were aiming for a zero failure regime then there would be no need for redress mechanisms. As noted in Chapter 4, PII and other redress requirements are common in legal services in other countries and in other sectors.

### 3 Information provision

As noted in Chapter 2, Government and regulators use a wide range of tools to address risk in different sectors. One of the most commonly used is information requirements since these can help consumers themselves to understand the nature of the risks they face (including revealing the fact of certain risks) and, where appropriate, to take action to mitigate these risks. This chapter briefly considers some of the benefits of information provision relating to risks that consumers might face as well as highlighting why information provision may not always deliver these results. The aim of the chapter is to provide some basic theoretical and background evidence on information provision generally in order that these issues can be applied in Chapter 4 to redress mechanisms and changing PII provisions

#### 3.1 Benefits of information provision

The purpose of information provision within regulation is typically to help consumers to understand the choices they have, to help them to make the best choice for themselves and therefore to cause firms to respond by improving their offering to meet consumer needs.

Information provision is often favoured because it works with the grain of the competitive process, making competition more effective, and is often seen as a less restrictive form of regulation than many others. Information provision can be seen as a “market-reinforcing strategy”.<sup>6</sup> For example,

*“where inefficient outcomes are the result of inadequate consumer information, information remedies will usually be the preferable solution. Remedies which simply adjust the information available to consumers still leave consumers free to make their own choices, thus introducing less rigidity into the market. Such remedies leave the market free to respond to consumer preferences and production technologies change over time. For the same reason, information remedies pose less risk of serious harm if the regulator turns out to have been mistaken”<sup>7</sup>*

Risk problems faced by consumers can also be alleviated through information provision,

*“The central notion of the approach encompasses the idea that risk problems are fundamentally problems of ensuring that the **right information is available** and that lay people are able to **use the information properly**. In this view, risk problems are mainly problems of sufficient information and therefore need to be solved by the improvement of communication strategies. From this perspective this approach is close to the concept of market and price in normative or classic economics.”<sup>8</sup> (emphasis in the original)*

As well as helping to drive competition, information also helps to assure consumer protection,

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<sup>6</sup> Market-Reinforcing versus Market-Replacing Consumer Finance Regulation, Zywicki, George Mason University Law & Economics Research Paper Series 17-01 in Reframing Financial Regulation: Enhancing Stability and Protecting Consumers, Peirce and Klutsey eds.

<sup>7</sup> The Efficient Regulation of Consumer Information, Beales, Craswell and Salop, The Journal of Law & Economics, Vol. 24, No. 3, Consumer Protection Regulation: A Conference Sponsored by the Center for the Study of the Economy and the State (Dec.,1981), pp. 491-539.

<sup>8</sup> Literature Review: Economics and Risk, Social Contexts and Responses to Risk Network, Zinn, Working Paper 2004/2.

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*“The informed consumer ideal stands on the common ground between the goal of antitrust – the maintenance of an efficient, innovative competitive economy – and the goal of consumer protection – the avoidance of consumer deception or ignorance concerning the material features of products or terms of sale.”<sup>9</sup>*

Further, within legal services, the CMA has noted that consumers may not purchase legal services from the regulated market because of a *lack* of information about their options indicating that providing information can have an impact on the size of the market as well as on the choices that consumers make within the market.

### 3.2 Limitations of information provision

Although information provision is generally very beneficial because of the reasons described above, there are various cases where information will not always drive the positive impacts for effective competition and consumer protection.

#### 3.2.1 Alternative (or no) regulation may be better

As noted in Chapter 2, provision of information is not the only remedy available to regulators and alternative regulation may be better placed to address some underlying problems. For example, electrical appliances bring with them the risk of faults that could lead to fires, but rather than inform customers about this, product testing and process standards are relied on instead and consumers are not necessarily warned about the fire risk despite the fact that some latent risk will remain and that the consequences could be detrimental both financially and in terms of a threat to life. Often risks are not revealed to consumers simply because the likelihood of them arising, while not zero, is considered insufficient to justify the requirement to inform.<sup>10</sup>

#### 3.2.2 Behavioural factors and bounded rationality

Although information can be helpful where consumers can engage with the information, in reality consumers may be limited in the ability to do this and the LSCP is right to highlight the importance of being realistic with respect to the responses to information that can be expected from consumers. In particular, consumers may suffer from bounded rationality in which their ability to engage with the information is limited by cognitive abilities or other factors such as the time needed to make a decision. In addition, other issues highlighted by the behavioural economics literature can also reduce the effectiveness of information remedies. Some of the factors of relevance are considered below.

#### **Complexity**

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<sup>9</sup> Antitrust and consumer protection: exploring the common ground, Hobbs, *Antitrust Law Journal*, Vol. 72, No. 3 (2005), pp. 1153-1166.

<sup>10</sup> For example, crossing a road involves the risk of being knocked over, and while there may be some crossings in some areas with a “look right” sign painted on the road, pavements are not littered with signs telling the pedestrian to beware and in most areas barriers are not in place to prevent pedestrians from walking out into the road. Indeed the “naked streets” concept suggests that in some circumstances, removing street signs and barriers can lead to a drop in accidents because a lack of regulated information makes drivers more aware of their surroundings. See *Risk, Responsibility and Regulation –Whose risk is it anyway?* Better Regulation Commission, October 2006.

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Some information or facts are simply difficult to understand and indeed some information may deliberately seek to use complexity in order to limit the extent to which consumers understand it. There is much evidence from the financial services area that consumers struggle to understand mathematical concepts of proportions, percentages and probabilities and hence they may fail to accurately compute the implications of some information given to them.<sup>11</sup> As explained in section 5.4, this may be particularly relevant with respect to risks of insufficient PII.

This also highlights one of the difficulties for regulators namely that,

*“There are some paradoxes in how the public understands regulation and risk. People endorse a strong ethos of personal responsibility but also want protections and backups in place. They want more choice but recognise that they may struggle to understand complex information regarding the decision facing them.”<sup>12</sup>*

### **Information overload**

Separate from the complexity of information is that in some cases (often due to regulatory requirements), consumers can be presented with such a raft of documents that even if they can understand the content of each individual part, when taken as a whole they may simply fail to engage with any of it. Having too much information can also make it difficult for consumers to engage with the most important parts simply because they are unable to identify which information is the most important. In many regulated areas this has led to desires to simplify information and to highlight the key information that is thought (by regulators) to be the most important for consumers. For example, the Better Regulation Commission states,

*“Modern, proportionate regulation recognises that consumers differ in experience and expertise in relation to different kinds of products and services (which themselves differ in the risks they present), and need advice and information. That information needs to be accurate, clear and intelligible. It also needs to be provided through a genuine desire to inform consumers rather than simply to avoid litigation.”<sup>13</sup>*

In this regard it is interesting to note the example of the Architects Registration Board which has designed a short “Meeting with your architect” form which includes various questions that consumers should think about in advance as well as questions to ask the potential provider.<sup>14</sup> Questions of price, the content of the proposals and communication are highlighted while mention of PII is relegated to a short section at the end entitled “The Small Print”. Mention is made of adequate and appropriate insurance cover but no further details are given on the PII.

### **When information is delivered**

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<sup>11</sup> The Efficient Regulation of Consumer Information, Beales, Craswell and Salop, The Journal of Law & Economics, Vol. 24, No. 3, Consumer Protection Regulation: A Conference Sponsored by the Center for the Study of the Economy and the State (Dec.,1981), pp. 491-539.

<sup>12</sup> Public Understanding of Regimes of Risk Regulation: A report on focus group discussions with citizens and consumers; Lunt, Livingstone and Malik, September 2008.

<sup>13</sup> Risk, Responsibility and Regulation –Whose risk is it anyway? Better Regulation Commission, October 2006.

<sup>14</sup> Meeting with your architect, Architects Registration Board.

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The point at which consumers are able to engage with information will also determine their likely actions resulting from it. Information on some legal services can be standardised and compared in advance. However, for non-standard advice, information around the likely approach to the advice, and the expected costs may only be determined after time has been invested by both the consumer and the provider to understand various features of the case. In such circumstances, the likelihood that consumers would switch to an alternative provider in the light of information being provided will be somewhat reduced because consumers would need to invest further time with an alternative provider.

As explained further in Chapter 4, this does not imply that information delivered after the purchasing choice has been made has no value since information on redress could be usefully delivered at that point if the aim of such information is primarily consumer protection rather than changing the purchasing decision.

### **Context of information**

It is also important to understand the context in which consumers are seeking information or making decisions about their legal services provider. In particular, the urgency of needing advice or the vulnerability of the consumer's personal circumstances might mean that they make a decision under more time pressure than they might ordinarily prefer to do i.e. this may be a distress purchase. For example, in criminal matters, urgency might mean that finding *any* legal adviser who is able to take the case dominates issues of searching to find the best provider. Information that conveys some level of competence and being regulated may therefore be preferable to detailed information on PII. Further,

*“what people say when asked to focus on a particular risk may be at odds with what they actually do in the regular conduct of their lives, where the attention they give to any one risk is necessarily embedded in the broader spectrum of risks they may be facing, as well as the many other goods and services they want to devote time and resources to.”<sup>15</sup>*

### **Potential for over-response**

Although most of the issues described above are likely to reduce the extent to which consumers engage with and take action in the light of information, it is also possible that some information could give rise to a greater impact than might be expected or desired. For example, there is some evidence to suggest that consumers may over-weight low probability events compared to high probability events. Framing and anchoring effects could also elicit greater responses than in the absence of these effects.<sup>16</sup>

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<sup>15</sup> Being Economic: Perspectives on Risk and Rationality, Social Contexts and Responses to Risk Network, Mehta, Working Paper 2007/18.

<sup>16</sup> Framing occurs when presentation of information affects decisions e.g. presenting something as a gain compared to as a loss. Anchoring is where one (irrelevant) piece of information is used as a reference for subsequent decisions and individuals adjust their decision from that information.

### 3.3 Summary

Information helps educate consumers regarding the risks that they face both in terms of bringing the risks to their attention and also so that consumers can seek to mitigate these risks. Information provision works with the grain of competition, particularly where consumers have different preferences. In practice, the impact of information is subject to limitations of consumers and therefore regulators need to be realistic about the extent to which consumers will understand and respond to information.

### 4 Redress mechanisms

This chapter considers the adverse impacts consumers might face in relation to negligent advice, the redress mechanisms in place and whether consumer might be able to mitigate any residual risk

When the provision of legal services goes wrong from a consumer perspective, the impact of this has the potential to be very serious. Indeed from 2004-2014 some £1.96 billion of claims (including both consumer and non-consumer claims) were paid out by professional indemnity insurers in relation to SRA regulated firms. In addition to this figure, claims are also paid by the Compensation Fund and individual firms may make redress to their clients without recourse to their PII. Overall it is clear that the total value of redress is substantial.

#### 4.1 SRA redress mechanisms

It is the very fact that consumers are unable to bear the consequences, particularly the financial consequences, of poor or negligent advice, that has led to various redress mechanisms being in place for SRA regulated firms including:

- Complaints processes;
- Legal Ombudsman (to help assess complaints if consumers are not happy with outcomes from their legal services providers);
- Professional Indemnity Insurance (providing protection mainly against negligence and also dishonesty other than for sole practitioners); and
- Compensation Fund (providing protection due to dishonesty or failure to account for money, particularly in connection with dishonesty of sole practitioners).

The combination of all of these redress mechanisms seeks to limit the extent to which consumers have to bear financial risks and the subsequent consequences of things going wrong.<sup>17</sup>

##### 4.1.1 Residual risk faced by consumers

Assessment of whether consumers *can* bear financial risks associated to changing the PII requirements must therefore recognise that consumers only bear the *residual* risk beyond the limits of these protections. It is therefore helpful to have in mind the extent of this potential residual risk.<sup>18</sup>

For example, the SRA is considering reducing the minimum value of cover from £2/3 million to £1 million or to £1 million for conveyancing and £0.5 million for non-conveyancing. This change exposes consumers with particularly high value claims to the risk that they may receive lower compensation than currently.

The majority of PII claims by number are small in value and would therefore be unaffected by changes in the minimum limits. However, previous work by EPC found that if all claims between £1 million and £3 million became at risk of not being paid then between 2004 and 2014 at most 222

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<sup>17</sup> Indeed, it is notable that the CMA has suggested it may be desirable to extend some redress mechanisms to some non-regulated firms.

<sup>18</sup> Potential risks that consumers might bear because they are not aware of redress mechanisms are considered in section 5.3.

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claims and £147 million might have been at risk with a £1 million limit.<sup>19</sup> Of this, at most 156 claims and £102 million were consumer claims.<sup>20</sup> If the PII minimums are reduced to £1 million for conveyancing but £0.5 million for all other areas of work, at most around 442 claims (£260 million) might have been at risk of which at most 326 (£189 million) were consumer claims.

However, these figures are considered to be well above what would happen in reality. This is because in practice, not all firms would choose to reduce their single claims limit to £1 million and many firms would have internal resources from which claims beyond PII limits could be paid. Indeed, from 2004-2014 there were only 19 cases in which under-insurance could theoretically have been a problem of which at most 12 cases related to individual consumers.<sup>21</sup>

Further, as well as holding PII that meets the MTC, firms are also required to hold “appropriate” insurance. If, for example, firms regularly conduct conveyancing transactions for more than £1 million it might be expected that they would hold higher PII coverage than the minimum required. Overall therefore, on average fewer than 33 consumers per year (and possibly only 1) are anticipated to be placed at risk from reducing the minimum claims limit.<sup>22</sup>

If the reforms are more proportionate, then better value for money would result both from the direct effect of reduced regulatory costs leading to lower prices but also from the greater competition arising from lower barriers to entry and supply side flexibility. As such this would reduce the financial risks to consumers as a whole by bringing better value for money and also by bringing consumers into the regulated market who are currently just priced out of it.

However, it is also clear that the impact of changing PII conditions is not only one that is felt by the average and potential consumer (through lower prices of their legal services) but is also one that is felt by a small number of consumers who may no longer receive the same level of protection as they do currently. For any particular consumer whose lawyer had insufficient PII cover and who had a very high claim, the detrimental financial impact of lower PII cover could be severe.

### 4.2 Redress mechanisms in other areas

Judgements on whether individuals are able to bear the consequences of poor or negligent advice can be informed by experiences in other countries and sectors. The level of PII in place reveals the extent to which regulators believe consumers should be protected from bearing financial risks. A summary of the levels of PII for some sectors and countries is provided in Table 1 below.

**Table 1: PII in other areas**

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<sup>19</sup> Potential options for SRA PII requirements, A report for the Solicitors Regulation Authority, EPC, May 2017.

<sup>20</sup> EPC calculations based on SRA data.

<sup>21</sup> The SRA could monitor under-insurance with respect to conveyancing on an ongoing basis in early years by matching high value conveyancing transactions from the Land Registry with information from insurers on PII coverage. Transactions with a value higher than PII may not be problematic, but it could be a risk factor feeding into the SRA’s general monitoring. However, such an approach does not appear possible for other areas of law that might give rise to high value claims.

<sup>22</sup> This is based on calculating an annual average from the 326 consumers with claims in 2004-2014 from two paragraphs above; and from 12 consumers with claims in 2004-2014 from one paragraph above.



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Sector	Minimum requirements
Architects	“Adequate and appropriate”; guidance indicates that firms are expected to hold a limit of at least £250,000
Accountants (ACCA)	Income up to £200,000 greatest of: 2.5 times income; 25 times the largest fee in the last year; £50,000. Income of £200,000-£700,000 greater of: aggregate of fee income and £300,000 and 25 times the largest fee in the last year. Income over £700,000 greater of: £1,000,000 and 25 times the largest fee in the last year.
Accountants (ICAEW)	£1,500,000 for any single claim; or 2.5 times gross fee income (where fee income is less than £600,000) with a minimum of requirement of £100,000.
Financial advisers and others under the Insurance Mediation Directive	€1,120,200 for a single claim and €1,680,300 in aggregate (£990,000 and £1,490,000 respectively but note that the limits are set in euros not sterling).
Surveyors	£250,000 minimum for turnover less than £100,000 £500,000 minimum for turnover £100,001-£200,000 £1,000,000 minimum for turnover greater than £200,001
<b>Other countries</b>	
Australia	Aus\$2,000,000 (£1,170,000) for solicitors; Aus\$1,500,000 (£880,000) for barristers
Canada	CAN\$1,000,000 (£600,000)
Ireland	€1,500,000 (£1,330,000)
Scotland	£2,000,000
<b>Other legal regulators</b>	
Bar Standards Board	£500,000
Council for Licensed Conveyancers	£2,000,000

Source: Architects Registration Board, PII FAQs; Professional Indemnity Insurance Requirements, ACCA; Professional Indemnity Insurance Regulations and Guidance Effective from 14 June 2017, ICAEW; Professional Indemnity Insurance, FCA, updated 25 May 2016; Professional Indemnity Insurance Version 3 with effect from 1 November 2015, RICS; Professional Indemnity Insurance, Australian Legal Services Council, 30 June 2016; Professional Liability Insurance: Not just an unwelcome expense for new lawyers, Canadian Bar Association, 13 January 2016; Professional Indemnity Insurance Regulations 2017, Irish Law Society; Professional Indemnity Insurance, Law Society of Scotland. Minimum terms of entity cover, Bar Standards Board; Professional Indemnity Insurance, CLC.

The examples in Table 1 above show that the current SRA limits of £2/3 million PII cover are at or above the maximum of the limits seen in other sectors. In addition, they show variety in the minimum level of cover between different areas reflecting different regulators’ judgements on the risks that consumers should be protected from. That there is variation may indicate that there is no absolute level of risk that regulators have identified that consumers are (un)able to bear in all circumstances. If that were to be the case, one might expect PII coverage to be the same across sectors.<sup>23</sup>

Some regulators have indicated that the minimum level of PII is based on the claims experience in the applicable area and set with reference to information from insurers. No evidence has been identified indicating that consumer testing of PII limits has been used to set the levels. Previous

<sup>23</sup> Or at least one might expect the PII coverage to be the same across professions where negligence may affect most consumer’s primary financial asset namely their home.

## Consumer risk in legal services

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work for the SRA suggested that historically the minimum cover for solicitors was set at a level that reflected a complex personal injury case; the current proposals by the SRA are informed by an examination of actual PII claims arising over a decade.

It is also worth noting that none of the regulators above have required that firms hold PII cover to such an extent as to completely eliminate all possible risk to consumers. Hence in reality consumers do bear at least a degree of risk in the PII arrangements in all sectors.<sup>24</sup>

### **Financial services case study**

There is some evidence that the risks in the financial services sector are considered by consumers to be greater than risks elsewhere.<sup>25</sup> For example, in relation to financial services, based on focus group discussions with consumers which had revealed concerns about various financial services products and mis-selling scandals, it was noted,

*“the potential costs to the individual are considered so great, and the decisions involved so complex, that they do not consider it fair to take full responsibility”<sup>26</sup>*

It is useful therefore to examine the role of the Financial Services Compensation Scheme (FSCS) which provides protection for deposits of up to £85,000 per person per bank.<sup>27</sup> Information about this level is well publicised, particularly when the limit has changed, and banks have been required to send prescribed information about it to customers. Consumers are not expected to know about the likelihood of failure of different banks, but risk mitigation (by spreading deposits between multiple banks) is expected nonetheless and is relatively straightforward.

Of particular note, however, is the fact that the FSCS also has provisions in place for temporarily high balances of up to £1 million (but not all balances).<sup>28</sup> Such balances are protected for six months in the case of certain life events (marriage, divorce, house buying, redundancy, retirement, receipt of insurance benefits or certain compensation payments). This additional protection recognises that the impact on individuals should they lose a substantial part of their finances would be dramatic and that it is unreasonable to expect individuals to be able to mitigate this risk immediately after they deposit funds due to the life events in question. It is notable that the life events covered have some similarity to events on which consumers might also seek legal services.

### **Insurance mechanisms**

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<sup>24</sup> The risk consumers bear also depends on other regulatory protections.

<sup>25</sup> In particular, when comparing financial services and communications, risks in financial services were seen as greater and more relevant to the individual compared to those in communications which were seen as having more of a public interest element to them. Source: Public Understanding of Regimes of Risk Regulation: A report on focus group discussions with citizens and consumers; Lunt, Livingstone and Malik, September 2008

<sup>26</sup> Public Understanding of Regimes of Risk Regulation: A report on focus group discussions with citizens and consumers; Lunt, Livingstone and Malik, September 2008

<sup>27</sup> Other aspects of the FSCS cover risks in other parts of financial services.

<sup>28</sup> While FSCS information sent to consumers does mention the temporary high balances this is relegated to the small print and the level of protection is not disclosed. The lack of disclosure may be to prevent distraction to other consumers or to encourage risk mitigation even when individuals might be covered by the temporary high balance rules.

## Consumer risk in legal services

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In theory, another way to assess the extent to which consumers are willing to bear financial risks is through looking at retail insurance markets. Markets for income protection policies or building and contents insurance could give an indication of the financial risks they are willing to bear compared to those financial risks that they do not wish to bear and therefore seek insurance to protect themselves against.

In practice, however, many of the same informational and complexity problems described in section 3.2 apply in these markets including the difficulties that consumers have in assessing low-probability-high-impact events. Further, the level of insurance coverage in these markets is typically far below the limits of PII that are being considered and therefore it is not clear that any evidence from these markets would be directly applicable to the SRA's decisions regarding PII.

### 4.3 Role of redress mechanisms

Before examining whether consumers can take steps to mitigate risks associated to a lack of full redress in legal services, it is worth thinking about the role of redress mechanisms and their implications for information provision. Redress mechanisms can have a number of different functions:

- First, they are there to deliver redress in the event that something goes wrong i.e. there is a pure consumer protection function to them. For this function, information is not necessarily needed during the search process or in advance of the purchasing decision, but consumers need access to this information when something goes wrong so that they both know they can receive redress and also how to obtain it;
- Second, and tightly connected to the first reason, they have a market confidence function. Knowing that a firm, or sector, is regulated and has redress mechanisms can make consumers more willing to participate in that market and this can therefore increase the size of the regulated market. For this function, information would be needed during the search process although it does not need to be specific to a particular firm or provide exact details of the redress mechanism, simply to state that they are present; and
- Third, in theory, they can have a direct competitive effect if there is variation in the redress between providers. For this function, information would be needed during the search process, or at least before the purchasing decision, and would need to be specific to a particular firm.

In the context of these different roles, it is interesting to note that the CMA appeared to differentiate between:

- “Whether consumers can access, assess and act on information about legal services so that they can make informed purchasing decisions and thereby drive competition for the supply of legal services”; and
- “Whether information failures result in consumer protection issues that are not being adequately addressed through existing regulations and/or redress mechanisms”.

## Consumer risk in legal services

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The fact that the CMA connects information on redress to consumer protection rather than driving competition, could be indicative that information about redress is not a key driver of purchasing decisions when deciding between regulated firms.

This is not to suggest that redress mechanisms have no impact on competition even where they are not intended to alter the purchasing decision of consumers. While all firms will incur costs in participating in redress mechanisms, it is low quality providers that will actually need to make redress which is costly due to the time taken to deal with consumer complaints and the actual compensation payments that must be made. While PII cover means that the majority of the claim is likely to be paid out by insurers, firms will have to pay some portion of the claim (unless they have a zero excess under the policy) and their future PII premiums would increase in the light of claims. As such, redress mechanisms raise costs for low quality firms to a greater extent than for high quality firms. This alone may cause some low quality firms to exit the market or to raise prices which, if consumers have a degree of price sensitivity, will cause them to lose business.

### 4.4 Summary

Consumers face only residual risk beyond regulatory protections and previous work has examined the potential risks of changing PII cover overall. Yet there is a risk to particular consumers who have reduced protection from lower PII cover and could face severe detrimental financial impacts.

Information on redress mechanisms can help deliver consumer protection, promote market confidence and potentially alter purchasing decisions. The SRA's reforms to PII are aimed at making a more proportionate form of consumer protection and thereby reducing the barriers to entry that the CMA has highlighted. This *is* aimed at improving competition, but via greater flexibility on the supply side as barriers to entry from regulatory costs fall, rather than via the demand side with consumers taking greater action.

### 5 Consumer engagement with redress information

As is clear from Chapter 4, the nature of the information in relation to redress that it is appropriate to provide to consumers varies according to the purpose of that information. This chapter seeks to provide practical implications of the previous chapters and to set out some of the kinds of consumer testing that could be conducted in order to help the SRA's decision making.

In the context of a current lack of appropriate information, the CMA has recommended that various pieces of information be provided to consumers in the legal services market including on price, quality of service, regulatory status, and redress. However, due to the various issues explained in section 3.2 above there may be trade-offs to be made regarding the extent and timing at which information is provided to consumers. In particular, it may be appropriate for some areas to have less detail in order that consumers focus their attention in other, more important, areas.

Put another way, consumers could be thought of as having a limited supply of informational attention and regulators should aim to ensure that this is directed to the areas that will generate the greatest consumer benefit (or reduce the greatest amount of consumer risk) overall. Otherwise there is a danger that consumers use up their time and attention in comparing between advisers on issues that actually make very little difference to the average consumer.

The SRA is already planning to conduct randomised control trials (RCTs) on the provision of information. RCTs of this nature can combine pieces of information, presentation of that information and/or wording in different ways in order that the separate impact of different aspects of the information can be identified.

RCTs can also test whether consumers have understood what the information is communicating and whether this alters according to the extent of information that is provided. They can also test for hypothetical responses to the information given including assessing whether it would make consumers more likely to search between different providers, or how many providers they might consider searching between. For example, if consumers identify what appears to be a regulated standard of information at one provider this may make them more likely to search for something similar at an alternative provider compared to the situation in which information, while provided, seems less standardised.

One well known difficulty with testing the impact of information is that it is typically conducted in hypothetical situations in which consumers are asked to consider their behaviour without actually being in the situation where the information would be provided in practice. As indicated above, consumers may not always respond in the same way outside test conditions. RCTs and other such tests can be very helpful in considering comparative information to establish what information might be most effective, but they may be weaker at determining what the impacts will actually be in practice.

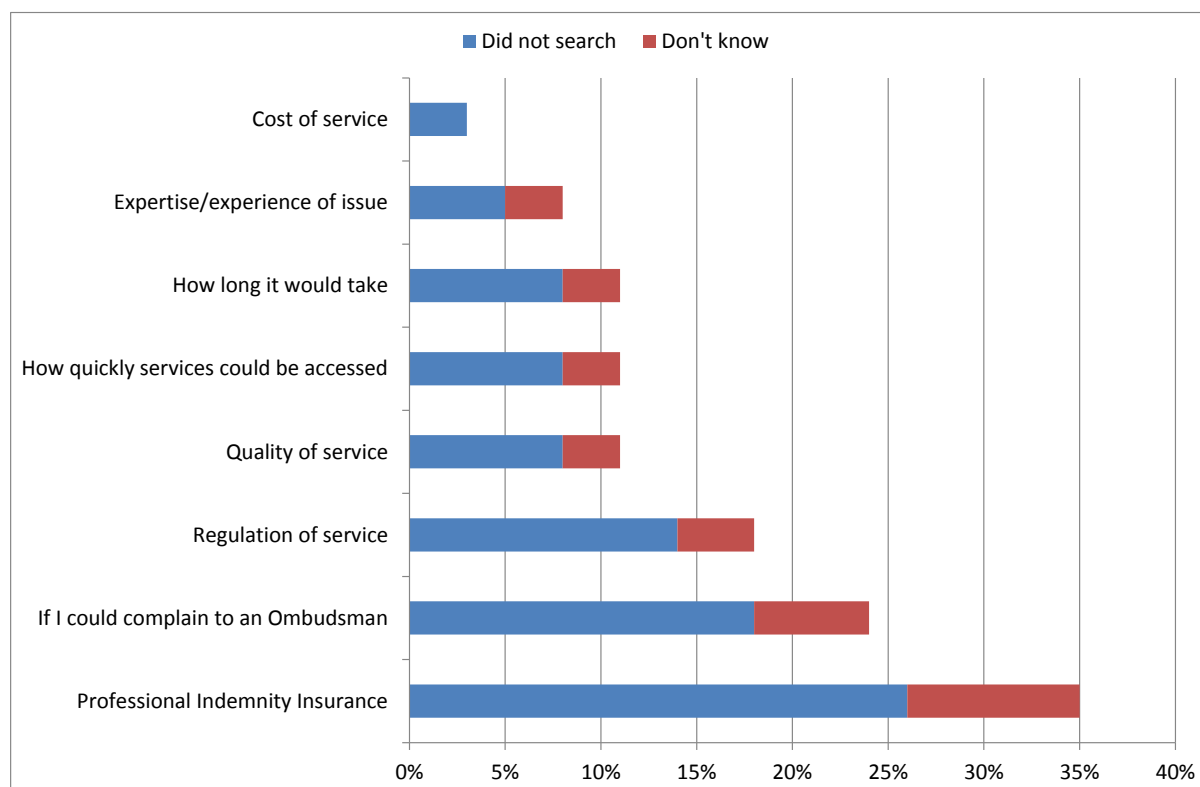
#### 5.1 Unprompted search on redress

It is helpful to understand consumer's current behaviour with respect to information about redress as a starting point to the design of future testing and to assess whether consumers realise that they face different kinds of financial risk. The LSCP's tracker survey has data on how easy or difficult it is

## Consumer risk in legal services

for those consumers that shop around to find information on various different issues and also reveals evidence on whether or not consumers in fact searched for information on these issues.<sup>29</sup> Figure 1 below shows, of those consumers that shop around, what proportion did not search for information about the particular issue, or did not know how easy or difficult it was to find that information (which may also suggest they did not prioritise searching for it).

**Figure 1 Consumers who shop around but did not search on various issues**



Source: Legal Services Consumer Panel Tracker Survey 2017. This question was asked to those respondents who stated that they shopped around when choosing a legal services provider. The question asked was: When shopping around for a legal services provider, how easy or difficult was it to find the information you wanted on each of the following?

The evidence indicates that consumers were substantially more likely to not have searched on the basis of issues surrounding redress (PII or access to an Ombudsman) compared to issues surrounding cost, expertise and service. Arguably, this indicates that providing information on the other issues at the point of shopping around (rather than information on redress) works with the grain of the information that consumers already view as being of more relevant to their decision process whereas information on redress is not currently believed to be relevant.<sup>30</sup>

Consumers could be asked for the reason that they do not search on issues surrounding redress. For example:

<sup>29</sup> Legal Services Consumer Panel Tracker Survey 2017.

<sup>30</sup> Regulators may, of course, believe that consumers “ought” to search on the basis of redress mechanisms and this is considered further in section 5.4

## Consumer risk in legal services

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- Why did you not look for information on complaining to an Ombudsman / Professional Indemnity Insurance:
  - Other information e.g. on price was more important;
  - When searching I wasn't think about what could go wrong with the advice;
  - I thought all legal providers would have the same protections; and
  - I don't need information on complaining unless I have something to complain about.

Such questions about existing behaviour could be asked in the RCT. Alternatively, since the Tracker survey already asks the question about the ease of finding information, it may be possible to add a follow up question into the survey or to ask questions about this with qualitative focus groups since they typically allow for greater probing of the explanations of behaviour.

As well as follow up to the LSCP question, consumers can also be asked whether they understand that they face different types of risks:

- When you chose your legal adviser, what issues did you think about where there was a risk that something to do with the relationship might not turn out as you expected?<sup>31</sup>
- When you chose your legal adviser, to what extent (a lot, a little, not at all) did you think about:
  - Whether you might not receive the quality of advice you wanted;
  - Whether you might not get the service you wanted;
  - Whether you might pay too much;
  - Whether you might not pay the price you expected;
  - What would happen if you were not satisfied with the advice;
  - What protections were in place if you were not satisfied with the advice;
  - How you could receive redress if you were not satisfied with the advice; and
  - What could go wrong if you didn't take legal advice.
- Please rank the importance of the different issues listed above.

These questions help to reveal the extent to which consumers think about the prospect that something could go wrong with the advice and that this could have detrimental consequences.

### 5.2 Market confidence

In order to test whether information on redress makes people more confident to use legal services, consumers could, quite simply, be asked a question along these lines:

- Does the information make you more confident in using legal services?
- Compared to a legal service provider who did not provide this information would you be:
  - More likely to use this one;
  - Less likely to use this one; or
  - It would make no difference in the choice.

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<sup>31</sup> This might be easier to test with focus groups rather than in an online survey.

## Consumer risk in legal services

Questions of market confidence may be of particular relevance if the SRA is also testing the use of regulatory logos to convey a sense that the information is mandated or approved by the regulator which in itself may provide confidence. The location of the logo may impact this, for example, the logo could be particularly associated to issues of redress conveying the sense that redress mechanisms are regulatory requirements compared to information about price and quality of services. An illustration of alternative approaches to this is provided in Figure 2 below.

**Figure 2 Market confidence and redress**



Source: EPC

Using variations of the information that is provided to consumers along with the question about confidence enables an assessment to be made of whether:

- The information in “your rights” impacts confidence;
- The logo impacts confidence; and/or
- The association of the logo with “your rights” impacts confidence.

Ideally, some consumers in the RCT would be those that have used legal services in the past but not used a regulated adviser. Some may not have used regulated legal services because of the lack of confidence in the sector (which would need to be established). If so, then the increased confidence and any increased willingness to use an adviser providing this information could be taken as evidence that information provision might have a role in increasing the size of the regulated sector.

### 5.3 Delivering redress

In order to test whether information on redress means that consumers are able to *obtain* redress in practice, before seeing information consumers could be asked how they would seek redress:

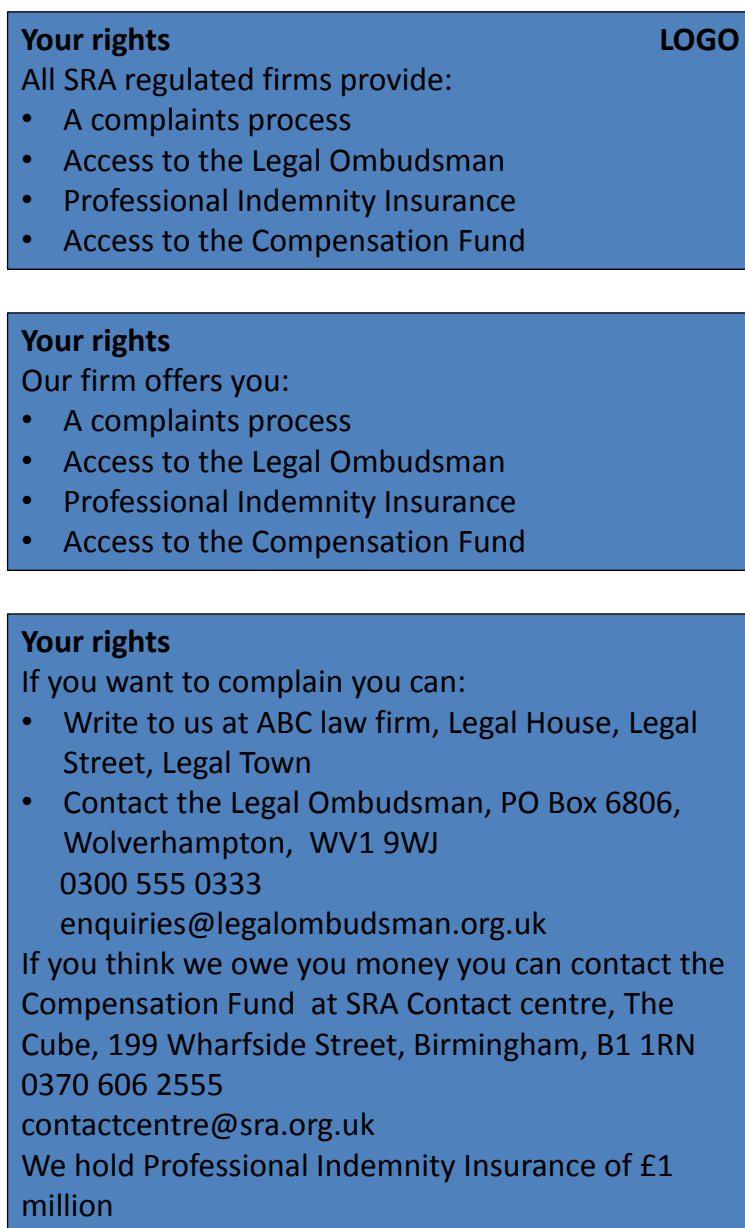
- What would you do if something went wrong with the advice you were receiving?
- If any complaint was not resolved by the firm to your satisfaction what would you do next?

These questions would help to obtain a baseline of the actions of consumers absent information.

Figure 3 below shows different options for the sort of information that could be provided on redress, the impact of which can be assessed through the RCT.



**Figure 3 Delivering redress**



Source: EPC

The RCT can be used to determine the impact of the logo, the reference to SRA regulation, language used and the detail given. At the same time the impact on the information delivered as a whole also needs to be taken into account, particularly in relation to the third example which provides contact details and therefore would take up more room on a sheet of paper or a website page which alone could lead to less attention being placed on other information disclosed at the same time.

Consumer behaviour in response to the different options can be considered by repeating the two questions in the bullets above regarding how they would seek redress. In addition, questions can be asked about:

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- When would you like the information on redress?
- Why do you think firms have Professional Indemnity Insurance?
- Do you think £1 million of Professional Indemnity Insurance would be sufficient for your needs?
- What would you do with this information about your rights:
  - File the information for later if dissatisfied;
  - Be more confident to use the provider because of the regulatory protections;
  - Ignore it because it would be the same for everyone;
  - Ignore it unless a firm didn't have the same information;
  - Using it to compare to the value of assets on which advice is sought; and/or
  - Compare PII to the level held by other providers.

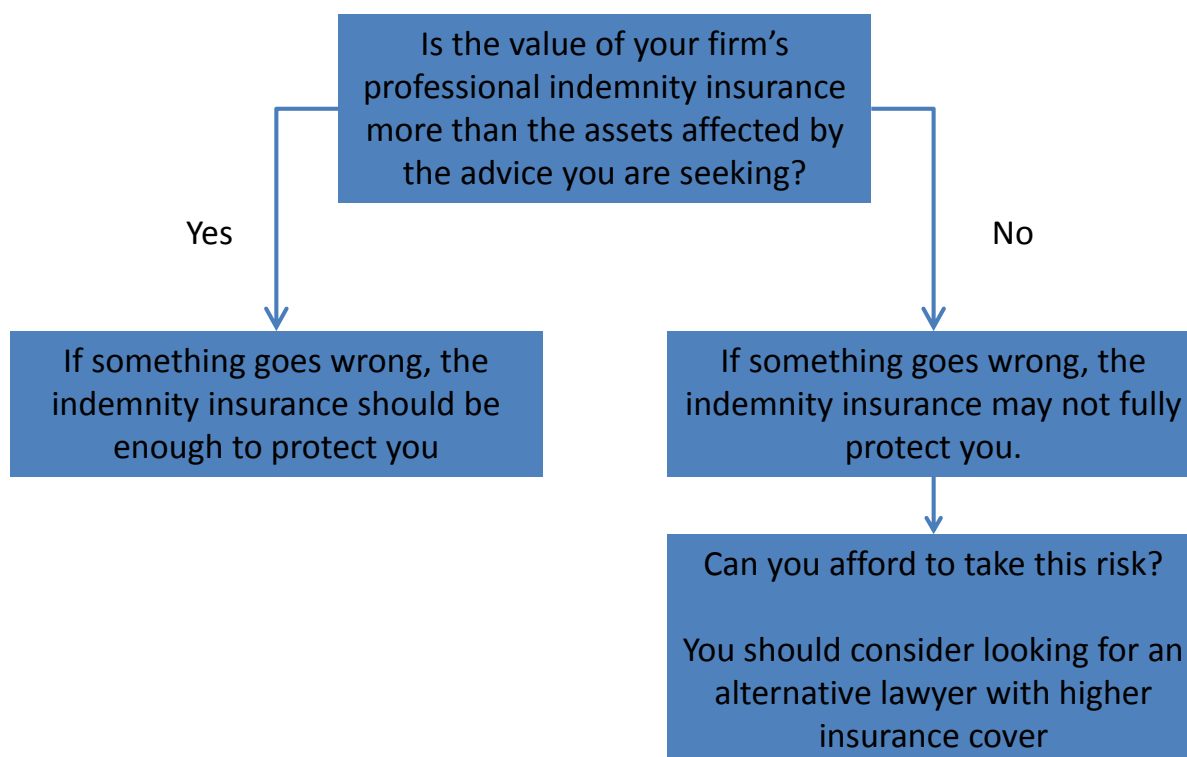
### 5.4 Influencing purchasing decisions

This section considers the type of information that might need to be delivered in order for information provision about redress is to influence purchasing decisions so that consumers can take steps to mitigate any residual risk that they might otherwise face. Section 5.4.1 considers information disclosure in relation to the value of PII, while section 5.4.2 considers, more briefly, information disclosure in relation to misrepresentation and dishonesty.

#### 5.4.1 Value of PII coverage

In order for consumers to understand the potential risk they face from insufficient PII coverage to meet their claim, there are a number of factors that they would need to consider. Figure 4 below provides an illustrative prompt of how these issues could be drawn to the attention of the consumer and what actions they could take to mitigate this risk.

**Figure 4 Illustrative approach on PII coverage**



Source: EPC

While this may at first glance appear a reasonably straightforward guide, there are a number of further questions that it raises in relation to each of the four boxes which are discussed below.

### ***Value of assets***

The first question to consider is whether consumers are able to assess the value of assets which may be at risk in the case of receiving poor quality advice. In some cases this may be reasonably clear:

- For conveyancing, the maximum value is likely to be the value of the property; and
- For wills and probate, it is likely to be the value of the estate.

In other cases, determining the value of the assets may be part of the legal service itself and therefore difficult for the consumers to identify in advance. For example in personal injury or medical negligence claims, the individual consumers may not know the appropriate level of compensation that they might be entitled to, indeed they may have sought legal advice to help determine this.

In addition, for some legal services, the asset concerned may not be specified in monetary terms. For example:

- For criminal cases, negligence may mean longer jail time;
- For family cases, negligence may mean losing custody of children; and

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- For immigration cases, negligence may mean losing residency.

In each of these cases, converting the downside risk of things going wrong into a monetary value that can be compared to the value of PII cover is very difficult. Ultimately, any PII payments would be made in monetary terms, but the conversion between the impacts above and the value of the claim is not straightforward for a consumer to consider in advance of making a decision about a legal services provider.

Furthermore, even when it is possible to quantify the value of assets, this does not necessarily imply that consumers will recognise that these are the relevant values to consider. In particular, consumers may believe that the relevant value to consider is the price that they are paying for the legal service. In addition, consumers may suffer from the problem of anchoring in which they compare the cost of say £200 for the preparation of a will, to PII cover of £1 million and mistakenly believe that the insurance must be sufficient to cover any eventuality because it is vastly greater than the price. To prevent this it may be possible to add extra information to the first box along the lines of, “These assets might be the value of a property or estate or the potential value of a medical negligence or personal injury claim.”

### ***PII should protect you***

Even in the cases where the value of the assets may be quantifiable at the time at which legal advice is received, this does not imply that the value of the assets will be the same at the point at which any claim might be made. For example, the value of an estate may be known at the point at which a will is prepared, but may differ substantially from this by the time the estate enters probate.

Similarly, the value of the PII cover could also vary over time. In particular, if the law firm has PII cover in excess of the minimum requirement at the time at which advice is taken out, this may no longer be the case by the time a claim is made.<sup>32</sup> Consumers may have chosen a provider with a high level of PII cover because they believe that this is the prudent course of action, but may subsequently discover that the PII cover has been reduced. The consumer is not in a position to know this and can in no way influence the subsequent actions of the law firm. Further, most consumers are likely to have little understanding of the “claims made” basis of PII in which it is the PII in place at the time of the claim, rather than the PII in place at the time the advice is given, which forms the basis of the protection. A notable implication of this is that even consumers who seek to mitigate risk by choosing firms with higher PII cover may ultimately find that they do not have the protection they sought.

### ***PII may not protect you***

If the intent of information is to drive competition by comparisons of PII cover, then more information would be required by a consumer either who wanted to know if it was worth searching

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<sup>32</sup> Changes in the regulatory requirement over time may need to take this into account where the PII value is reduced such that historic claims receive at least the minimum level of cover that was in place at the time that the advice was given. This is noted in Potential options for SRA PII requirements, A report for the Solicitors Regulation Authority, EPC, May 2017.

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(since this is costly) or who, having searched, now wanted to make a judgement on the extent of the risk that they were facing in practice. For example, in order to trade-off a lower price at one provider with £1 million PII cover compared to a higher price at another provider with £2 million PII cover, a consumer would also want to know details on the possible exposure to risk that they faced which would involve information on:

- Value of possible claims;
- Likelihood of any of these claims arising;
- Value of PII coverage; and
- Value of assets at the firm.

Ideally consumers would want to know this for the particular area of work that they are seeking advice on since knowing average risks and claims may not be of relevance if it varies substantially between different areas of advice (conveyancing is known to represent a particularly large value of total claims). Further, consumers would want to know the risk of claims from the particular firms that they are comparing.<sup>33</sup>

Consumers are not actually exposed to the total value of claims both because PII would pay out for the amount of the cover insured but also because the law firm itself would be obliged to pay any surplus amount if it was in a position to do so. Hence the value of assets at the firm is important since even with insufficient PII coverage, consumers would not be exposed to any loss if the firm has sufficient funds to make up the difference. However, the value of assets at a firm may also be affected by any claims that are made by other consumers which any individual consumer is unlikely to be in a position to assess particularly in respect of some indeterminate point in the future when the claim is made.

It is unrealistic to provide the data that allows consumers to make this trade-off and, as identified in section 3.2, equally unrealistic to expect consumers to be able to understand the data even if it was provided. Indeed,

*“if consumers do not process risk information reliably, these policies will not be effective. Moreover, if decisions involving low-probability events do not display individual rationality, informational policies also may not remedy these difficulties.”<sup>34</sup>*

### **Prompts for action**

As highlighted in Figure 4, it could be possible to seek to provoke a response in the absence of the detailed information on the extent of risks simply by drawing attention to the impact of the financial risk that could be faced. Indeed this may provoke a response as noted below,

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<sup>33</sup> While past claims might help to inform this, many firms will never have faced a PII claim but this does not imply that there is zero risk of them having a positive claim in the future.

<sup>34</sup> Informational regulation of consumer health risks: an empirical evaluation of hazard warnings, Viscusi, Magat, Hubet, The RAND Journal of Economics, Vol 17, No 3 (Autumn 1986). Individual rationality would imply that individuals behaved in a consistent way when presented with information e.g. they would not be subject to framing or anchoring where the way that information is presented, or the other information presented, affects they decisions.

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*“we are better able to apprehend the potential impact of a given risk than a finegrained appreciation of wide differences in the probability of its occurrence...certain risk events seem to garner greater attention because of their visceral nature.”<sup>35</sup>*

Yet it is questionable as to whether it is proportionate to want all consumers to seek to mitigate this risk given the small proportion of high claims compared to the number of transactions. For example, conveyancing claims of over £1 million represent less than 0.03% of the number of property transactions over this value.<sup>36</sup>

Hence even for conveyancing transactions (where PII claims are disproportionately common), prompting all consumers to look elsewhere may result in a disproportionately large search cost. As highlighted in section 3.2, in as far as consumers have a limited capacity to search across all of the relevant features of the legal services market this could also distract them from looking at other factors which may be more important for consumers as a whole. This may be particularly the case if, for example, it is only in relation to PII that there is a prompt for action in information disclosure.

However, if less than full information is provided to consumers, for example, only comparing the value of assets with the value of PII, consumers would need to be tested to assess whether a decision to accept the risk of PII being lower than the value of assets is because consumers do not understand they bear a risk, because they take an optimistic view of the likelihood of a claim (in the absence of any knowledge to the contrary), or because they believed that they would face the same risk at other providers.

### **Summary**

As explained above, the information needed to make a fully informed decision about the financial risks involved in the limits of PII is too complex to expect consumers to be able to understand or to take action to mitigate their risks.

If more simple information is provided in order to prompt consumers to mitigate the risks that they face through PII, the SRA would need to be confident that a subsequent lack of action reflects a deliberate decision to bear the risk rather than mistaken understanding. If instead, the regulator believes that most consumers would be unwise bear this risk, then, as illustrated in Figure 4, information on PII limits alone may be insufficient to convey this. Rather than just telling consumers that the PII cover may not be sufficient, and that they may not be able to afford any detrimental consequences, they may need to be more directing of an alternative decision and yet if that is a costly decision e.g. if firms with higher PII cover charge higher prices, the consumer is not in a position to be able to trade-off these effects.

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<sup>35</sup> Regulation and Risk, Haines in Regulatory Theory: Foundations and Principles.

<sup>36</sup> ONS data shows around 14,000 properties sold for £1 million or more in 2015, while SRA data shows that between 2004 and 2014, there were only 37 cases in which PII claims for more than £1 million were identified in residential conveyancing. Separate advice is typical for buyers and sellers, but non-SRA conveyancers could also advise on transactions hence 0.03% is based on 14,000/3.7 (rather than 28,000/3.7). Sources: £1 million property sales increased over 70 fold since 1995, ONS, March 2016; and EPC calculations based on SRA data.

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Information remedies may not be appropriate to help consumers understand and mitigate this risk for the market as a whole since not only would this be too complex for consumers, but the cost of bringing these remedies to bear on the market may be disproportionate.

### 5.4.2 Misrepresentation and dishonesty

The SRA has been considering whether changes could be made in respect of misrepresentation and dishonesty elements of the minimum terms and conditions (MTCs) within PII requirements.<sup>37</sup> Amongst other effects, if these changes are made, one impact would be to shift some risk onto consumers that they do not currently face. This report does not consider whether such an approach is appropriate since EPC's previous report has examined that question. Instead, this report considers whether it would be feasible to use information provision to help consumers to help understand or mitigate this risk.

It is quickly apparent that information provision to consumers on this issue would be limited in its effectiveness for the simple reason that information would not actually reveal anything that consumers can act upon. Much like visa forms that ask whether you are a terrorist, it is difficult to imagine the scenario in which a firm that has misrepresented information to their PII insurer will subsequently disclose this to customers in order that customers might take it into account in their purchase decision.

In theory it would be possible to reveal a generic risk that misrepresentation or dishonesty would limit the PII cover. However, given this would be a generic risk and apply across firms, it does not represent something over which consumers could make any distinction between different SRA-regulated providers. In addition requiring firms to declare to consumers that they may be dishonest does not seem an approach likely to build confidence in SRA regulated firms particularly when the vast majority of firms do behave appropriately.<sup>38</sup>

### 5.4.3 Consumer testing

In order to test whether information on redress impacts the purchasing decision, information along the lines of Figure 4 above can be tested in combination with the information in Figure 2 and Figure 3 as well as the other information disclosures on price and quality. The RCTs can test the impact of different information such as:

- All SRA regulated firms have professional indemnity insurance;
- Because firms might make a mistake, all SRA regulated firms are required to have professional indemnity insurance;
- All SRA regulated firms must have at least £0.5 million of professional indemnity insurance;

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<sup>37</sup> Currently, insurers are not able to avoid insurance on any grounds including in relation to misrepresentation. Similarly, the MTCs require that dishonesty must be covered wherever there is an innocent principal in the firm.

<sup>38</sup> It is possible that disclosure could cause consumers to take other steps such as sourcing other forms of insurance to cover the risk of something going wrong. However, alternative insurance is rare (title insurance may be available in some countries in relation to conveyancing transactions but alternative insurance for personal injury claims or criminal cases seems unlikely).

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- This firm has professional indemnity insurance of £1 million in case we need to compensate you for our mistakes; and
- This firm has professional indemnity insurance of £2 million. If this is less than the value of assets affected by the advice you are seeking then you should consider looking for an alternative provider with higher insurance.

The first three options focus on where the aims of the disclosure are to ensure consumer confidence in using firms regulated by the SRA, and to ensure consumer protection in the event of a problem by highlighting that protections are in place. The last two options provide firm specific quantitative information on the level of PII with the aim of influencing the purchasing decision.

### ***Shopping around***

In practice, testing all options through the RCT can ascertain whether there is a difference in shopping around behaviour and purchasing decision between the different options. The various questions set out in section 5.3 regarding the impact on consumer understanding on behaviour would need to be used to assess the differences between options. In addition, of particular interest would be:

- What impact would this have on your search behaviour:
  - More likely to shop around;
  - No difference; or
  - Less likely to shop around.
- How important would the following aspects of information be when you shop around (Very important, quite important, not particularly important, would not look at it):
  - Price;
  - Quality; and/or
  - Redress.
- Please rank the importance of information on the following issues in terms of how helpful you think it is for your decision of which legal services provider to use:
  - Price;
  - Quality; and/or
  - Redress.

Given the risk of information overload, the results regarding the impact on search behaviour will be of particular importance. For example, more detailed information on redress could prompt search on redress but at the cost of less search on price. Similarly, if PII and pricing information are the only pieces of information that are displayed in quantitative terms then consumers may take more notice of PII in comparison to other aspects of information which are explained in qualitative terms.

### ***Level of PII***

In the cases where the value of PII is disclosed, consumers could be asked whether they think the level of PII cover is appropriate:



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- Do you think £0.5 million of Professional Indemnity Insurance would be sufficient if anything goes wrong with the legal services provision;

In doing this, it should be recognised that the level of PII will look vastly greater than any of the other quantitative information displayed on pricing. As such there may be a substantial anchoring effect in which consumers compare the PII to prices and conclude that it must be sufficient.

In addition, one of the significant difficulties of testing whether different limits are appropriate, is that for the great majority of customers, any of the limits being considered by the SRA will be such that none are of significant relevance to them because the value of the assets on which they are seeking advice or might imagine seeking future advice is well below both limits. Indeed the limit is set with the very intent of ensuring that the vast majority of consumers will be covered by it.

For this reason, either customers would need to be asked hypothetical questions about what they would do if they were seeking advice on something that was of particularly high value, or alternatively the sample of customers used to ask questions about these risks should be those who are more likely to be in a position where they might seek such advice in reality. In the latter case, this would involve weighting the sample towards high net worth individuals, particularly those with substantial housing wealth. The views of this part of the sample might need to be the ones particularly taken into account in analysis.

### ***Willingness to pay***

If the RCT includes consumers observing multiple versions of information disclosure, then it would also be possible to assess their willingness to pay for higher insurance coverage. For example, consumers could be asked to choose which of two providers they would use for a particular task with various elements of the disclosure varied. In particular, by using different values for prices and PII, it would be possible to identify the extent to which consumers are willing to pay for higher PII, if at all. It is possible that their preferences might be such that information can be inferred for the appropriate levels of PII.

A significant weakness of this is that even if consumers are willing to pay more for higher coverage, this does not take into account the detrimental impact of PII restrictions on the wider supply of legal services or the impacts on those consumers who are currently excluded from the regulated sector due high prices.

Willingness to pay comparisons could also be used in testing other information such as the value of having a regulatory logo where consumers might be willing to pay higher prices for the confidence of knowing that the sector is regulated.

### **5.5 Alternative approaches to mitigating risk**

If information provision on PII limits can not be designed in a way as to influence purchasing decisions without unintended consequences, then alternative approaches may be preferable including:

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- The SRA could do nothing and simply acknowledge that the small impacts as overall are a necessary trade-off of the greater benefits that arise for consumers as a whole, notwithstanding the severe impacts that might result for a few consumers for whom mitigation can not be realistically expected;
- The SRA could require firms to have PII cover greater than the value of the assets involved for any consumer advice. However, even this would seem disproportionate for very high value transactions given the small risks involved. Further, this could end up substantially reducing choice for those with particularly high value assets on which they need legal advice or cause such transactions to occur at larger firms whose PII cover is typically higher than at smaller firms; or
- The SRA could choose to allow access to the Compensation Fund for the consumers exposed to the impacts of firms having insufficient PII and internal resources. Given the small number of cases anticipated the additional costs of providing this access would also be small.

Finally, although suggestions for consumer testing have been made throughout this report, the SRA also needs to be aware of the regulatory resources it expends. It is essential that consumers' interests are taken into account in designing regulatory policy (indeed their interests should have primacy) and this is reflected in the fact that the first principle associated to the assessment of PII in other work by EPC is to ensure that those who suffer loss are promptly and properly compensated.<sup>39</sup>

Notwithstanding this importance, given the small number of consumers that are expected to be detrimentally affected by changing the PII limits, this raises a legitimate question as to whether direct consumer testing of PII issues is a worthwhile use of regulatory resources. Since the SRA is conducting consumer testing anyway, the marginal cost of some questions on redress and the financial risks that consumers can bear may be small, but greater financial impact on consumers as a whole would be expected to result from the other areas of information provision that the SRA is assessing.

### 5.6 Summary

Various illustrations of the types of information that could be provided to consumers have been set out in order to help test the impact of information surrounding redress. As noted, redress information can have multiple purposes and one of the aims of the tests is to see whether it would lead consumers to alter their purchasing decisions in such a way as to enable them to mitigate any additional risks that they face due to changes in the PII MTC.

For consumers to be fully informed about the potential risks of insufficient PII appears to require overly complex information but some simple information on PII limits could be provided. RCTs can test whether this information is effective or whether it causes consumers to reduce their attention on other issues that may, ultimately, have greater financial impacts on consumers as a whole. Given the very small number of cases anticipated to be at risk, expending considerable regulatory effort and firm resources on providing consumers with the information to mitigate this risk may not be appropriate.

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<sup>39</sup> SRA PII requirements, A report for the Solicitors Regulation Authority, EPC, May 2017.