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| <b>To:</b>              | Legal Services Board |                            |
| <b>Date of Meeting:</b> | 27 April 2016        | <b>Item:</b> Paper (16) 24 |

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|--------------------------------|---|--|
| <b>Title:</b>                  | Unregulated Project Final Outputs   |  |
| <b>Workstream(s):</b>          | Understanding consumer choices and decisions across the regulated and unregulated sector (See <a href="#">LSB Business Plan 2015/16</a> ) |  |
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| <b>Status:</b>                 | Sponsor: Steve Brooker  |  |
| <b>Status:</b>                 | Official  |  |

**Summary:**

In March the Board approved the 2016/17 business plan, which provides for no further consideration of extending consumer protection to unregulated providers. We will, as also agreed with the Board, keep this under review.

This paper introduces the final outputs of the unregulated project, including a working draft of the mapping report and in depth research into unregulated providers in three market segments: will-writing, divorce and intellectual property. It also sets out the reasons that we are not seeking to pursue further consideration, at this stage, of extending consumer protection to unregulated providers.

The project has significantly advanced the evidence base on unregulated providers. The evidence demonstrates the following:

- For profit unregulated providers make up a small proportion of the legal services market, but the market differs significantly by market segment.
- The market segments which attract the highest level of unregulated provision are family (divorce), property, welfare and benefits, consumer problems, wills and intellectual property.
- Observed benefits to consumers include lower prices, and higher levels of price transparency and innovation, compared to regulated providers.
- The main risks to consumer detriment relate to consumers not making informed choices, misleading advertising claims and poor service.
- Satisfaction with customer service is broadly comparable across regulated and unregulated providers.
- More than half of consumers who instruct for profit unregulated providers are aware of their regulatory status. Of those who don't check, a significant proportion do not do so because they assume that they are regulated.

This evidence base will be factored into all future work that engages considerations about unregulated providers.

**Recommendation(s):**

The Board is invited to:

- (1) Note the key messages and learning that the project has generated (see paragraph 17).
- (2) Note the research report commissioned from Economic Insight (Annex A) and the working draft of the in-house mapping report (Annex B), both of which we intend to publish in the next few months (circulated electronically).
- (3) Note the rationale for not pursuing further consideration of extending consumer protection to unregulated providers in 2016/17.

**Risks and mitigations**

**Financial:** **Low.** No significant financial risks are identified.

**Legal:** **Low.** Legal advice was sought on the Economic Insight report and we have followed this advice to mitigate the risks identified.

**Reputational:** **Medium.** The outputs from this project will generate interest and potentially strong views from representative bodies, regulated and unregulated providers. It was with this in mind that we commissioned independent research and this utilised a robust methodology which drew upon a wide range of evidence. A comprehensive communications strategy and press lines will be prepared to accompany publication of the reports and next steps.

**Resource:** **Low.** No significant resource risks are identified.

| Consultation           | Yes  | No | Who / why?  |
|------------------------|--|----|---|
| <b>Board Members:</b>  | X  |    | Helen Phillips as the nominated Board lead on this project. Also, the Board considered an update paper at its October 2015 meeting.             |
| <b>Consumer Panel:</b> | X  |    | A paper was presented to the Panel meeting on 30 September 2015. Feedback from Panel members has been fed into the project and future planning. |
| <b>Others:</b>         | Meetings with approved regulators and representative bodies to explain the project and seek evidence on unregulated providers. |    |   |

**Freedom of Information Act 2000 (Fol)**

| Para ref      | Fol exemption and summary   | Expires |
|---------------|---|---------|
| Para 27       | Section 36(2)(b)(i): information likely to inhibit the free and frank provision of advice |         |
| Annex A and B | s.22 (future publication)   |         |

## LEGAL SERVICES BOARD

|                         |                      |                            |
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| <b>To:</b>              | Legal Services Board |                            |
| <b>Date of Meeting:</b> | 27 April 2016        | <b>Item:</b> Paper (16) 24 |

### Unregulated Project Final Outputs

The Board is invited to:

- (1) Note the key messages and learning that the project has generated (see paragraph 17).
- (2) Note the research report commissioned from Economic Insight (Annex A) and the working draft of the in-house mapping report (Annex B), both of which we intend to publish in the next few months (circulated electronically).
- (3) Note the rationale for not pursuing further consideration of extending consumer protection to unregulated providers in 2016/17.

### Background

1. The project had the following objectives:

- Advancing our understanding of the choices and decisions that consumers make when they have a legal problem;
- Analysing the benefits and risks presented by for profit unregulated providers;
- Providing an evidence base that helps to improve our effectiveness in promoting the regulatory objectives; and
- Informing an in-principle decision on whether we should seek to extend consumer protection to any unregulated providers.

2. To achieve these objectives, there were three main aspects to the project:

- (i) **In house mapping** of the unregulated legal services sector to identify how prevalent unregulated providers are in different areas.
- (ii) **Commissioning in depth research and analysis** of 'for profit' unregulated legal services providers in a limited number of key areas, identified from the in house mapping.
- (iii) **Analysis** of section 163 of the Legal Services Act (Voluntary Arrangements) to establish what scope it gives the Board to extend its remit to unregulated providers.

3. The Board was presented with an update paper on the project in October 2015. In this paper it was explained that the three strands of the project would be pulled together and presented to the Board in April 2016. In March 2016 the Board approved the 2016/17 business plan, which provides for no further consideration of extending consumer protection to unregulated providers but to keep this area under review in future years.

#### Scope of project

4. A key challenge for this project has been to limit its scope in order to allow for meaningful consideration of relevant segments of the unregulated market.
5. For the purposes of this project, providers were grouped into five categories, as follows<sup>1</sup>:
  - (i) **LSA regulated** – authorised persons.
  - (ii) **Non-LSA regulated** – Claims Management Companies and Immigration Advisers regulated by the Office of the Immigration Services Commissioner.
  - (iii) **Ancillary** – those whose function is not primarily as a legal adviser but who may occasionally provide some legal advice or other non-reserved legal services ancillary to their primary business e.g. doctors, accountants.
  - (iv) **Unregulated (not for profit)** – charities, trade unions, membership bodies.
  - (v) **Unregulated (for profit)** - providers that are not authorised and regulated under any legal sector specific legislation, provide legal services as a significant focus of their work and seek to make a profit.
6. The main focus of the project is on “unregulated (for profit)” providers.

#### In house mapping

7. The in house mapping report was compiled by staff and is based on analysis of the data from the 2015 Individual Legal Needs survey (ILN 2015), which is due for publication shortly, as well as internet and desk-based research. It provides an overview of the levels and types of unregulated provision across the market, by reference to the ‘type of consumer problem’ from the *Market Segmentation Framework* developed for the LSB by Oxera.
8. The report has contributed to improved understanding of the extent and composition of the unregulated market, in line with the core objective of this project. Details of the key messages are outlined below in paragraph 17 and a

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<sup>1</sup> For further detail see Annex A

working draft of the report is available at Annex B. The draft will be added to and finalised following further analysis of the ILN 2015 data. This will be undertaken in the coming weeks.

### In-depth research

9. In September 2015, SLT agreed that the in-depth research should focus on the following three areas:
  - (i) Will Writing and Estate Administration
  - (ii) Family
  - (iii) Intellectual Property
  
10. Following a tender process, we appointed Economic Insight to undertake the research. The core areas for analysis for each of the three markets, as set out in the research specification, were:
  - Unregulated services offered.
  - Main provider types and business models used.
  - The range of qualifications and experience of those providing the relevant legal services.
  - Client bases (by reference to the Oxera market segmentation model).
  - Client acquisition and broader marketing strategies.
  - Fees and charging structures used.
  - Benefits to consumers (by reference to Legal Services Consumer Panel (LSCP) Consumer Principles Framework).
  - An analysis of the risks to consumers (by reference to LSCP Consumer Principles Framework).
  - Existing (voluntary) protections and quality control.
  - Existence and nature of any interest groups or trade bodies.
  - Levels of interest amongst providers in voluntary regulation.
  
11. Economic Insight's final report is included at Annex A. The report explains the research methodology, which included:
  - Reviewing previous research.
  - Analysing data from the 2015 small business legal needs survey and ILN 2015.
  - Undertaking a review and codification of provider websites.
  - Interviews with key stakeholders.
  - Interviews with unregulated providers.
  - Desk based research, including a survey of customer review websites.
  
12. The report has significantly improved the evidence base and our understanding of the 'for profit' unregulated market in the three markets studied, contributing to

the core objective of this project. The key messages from this report and the in house mapping are outlined below in paragraph 17.

### Analysis of s.163

13. In order to inform a decision on whether we should pursue the establishment of a voluntary arrangement under s.163, the project team undertook the following steps:
- (i) A legal analysis was undertaken by the LSB's in-house legal team.
  - (ii) The Project Team met with the Professional Standards Authority for Health and Social Care and Trustmark, both of whom operate oversight arrangements for voluntary schemes which could be seen as comparable to what the LSB might seek to do under s.163.
  - (iii) Potential interest in an LSB voluntary arrangement, amongst existing voluntary regulators, was gauged through meetings to discuss the project.
14. From meetings with representative bodies and approved regulators the project team received some strong views on the establishment of a voluntary arrangement. The Law Society in particular reiterated the position expressed in its response to the 2015/16 business plan consultation that the LSB should not use funds obtained from the levy in order to fund the establishment or operation of a scheme for unregulated competitors of those who ultimately bear the costs of the levy. Similar concerns were expressed by some other respondents to the 2016/17 business plan consultation.
15. From the above work, the following conclusions can be drawn:
- Section 163 provides a broad scope for establishing a framework for oversight of voluntary regulators.
  - Voluntary oversight schemes require a significant level of resource input to establish and operate. This means that in order to be self-funding, a reasonable number of voluntary regulators and/or providers need to come within the remit of the scheme.
  - There is limited interest amongst unregulated providers or amongst existing voluntary regulators for further extension of regulation or an LSB voluntary arrangement and so it would be very unlikely that any voluntary scheme would be financially viable.
  - The Board will be aware that the LSB, in conjunction with the Ministry of Justice (MoJ) and Her Majesty's Treasury, are seeking to identify a suitable legislative vehicle to make an amendment to section 175 of the Act. This is to confirm the current practice whereby the LSB retains all amounts received through the levy and any prescribed fees rather than passing this over to the Consolidated Fund and then having the same amounts returned to it by the MoJ. This same amendment could allow the LSB to retain any funds it

receives for fees charged through a voluntary arrangement, as detailed in section 163. Pending this potential solution there is no direct means for fees charged through a voluntary arrangement to be recouped by the LSB.

## **Proposal**

16. The Board is asked to note three areas today. Each is explained in more detail below.

(i) Note the key messages and learning that the project has generated.

17. The primary objective of this project was to develop our understanding of the full range of choices available to consumers. The project has delivered against this objective and publication of the two reports that are annexed to this paper will result in this improved understanding being shared with the market. The Board is asked to note the following key messages and learning that the project has generated:

(a) **For profit unregulated providers make up a small proportion of the legal services market.** Across the 12 market segments that consumers were asked about in ILN 2015, for profit unregulated providers represented 2.9% of those who sought advice or assistance in dealing with their legal problem (including paid and unpaid services). This share climbs to 5.5% of cases in which consumers paid for advice/representation. In contrast, not for profit providers, most of whom will be unregulated, accounted for 37.1% of all legal problems where representation was sought.

(b) **The market segments which attract the highest levels of for profit unregulated provision are:**

- **Family** (10-13% for divorce)
- **Property, Construction and Planning** (10-11%)
- **Welfare and Benefits** (10-11%)
- **Consumer Problems** (9-10%)
- **Wills, Trust and Probate** (7% overall, rising to 9% for wills)
- **Intellectual Property** (7-8%)
- **Employment** (a minimum of 4-5% for small business consumers)

(c) **The market for unregulated providers appears to differ significantly by market segment.** This relates to the market share (which varies from no identified use in fully regulated areas such as immigration to a maximum of 13% in relation to divorce) but also the competitive environment. For example, within will writing there are over 1,600 for profit unregulated providers, who are mainly small or single person enterprises, whereas the market for online divorce is consolidated within five larger providers utilising 10 different trading

names. Further new findings on the supply side characteristics of three key market segments are included in the Economic Insight report.

**(d) For profit unregulated providers can present the following benefits to consumers:**

- Low prices (we have identified lower prices than regulated providers for wills and divorce in particular)
- High levels of transparency in pricing (we can evidence higher price transparency in wills and in divorce than regulated providers)
- High levels of innovation and service differentiation
- Through competitive effects, unregulated providers can help to drive improvements across the market.

Whilst most of these benefits have been articulated previously, the project has provided a more robust evidence base.

**(e) Satisfaction with customer service is broadly comparable across regulated and unregulated providers.** Across all problems, ILN 2015 demonstrated that 81% of consumers who had used for profit unregulated providers were satisfied with the service (compared to 84% who used LSA regulated providers) and only 8% were dissatisfied (compared to 7% for LSA regulated). There were no statistically significant differences across any of the more detailed satisfaction measures (e.g. concerning clarity of information, quality of service, communication and time taken).

**(f) More than half of consumers who instruct for profit unregulated providers are aware of their regulatory status. Of those who don't check, a significant proportion do not do so because they assume that they are regulated.** Results of ILN 2015 demonstrate that 57.1% of those who instructed an unregulated provider checked their status. Of the 35.4% who did not, 42.1% did not do so because they assumed that their provider was regulated.

**(g) The following factors may lead to consumer detriment for clients of unregulated providers (and are applicable across market segments):**

- Consumers not making informed choices.
- Misleading advertising claims.
- Poor service.

In this regard it is important to remember that the project did not involve assessing technical quality of services provided or gathering information from consumers. Therefore the project did not involve an in depth assessment of risks or consumer detriment. These factors had all been identified previously and the project has not resulted in significant new evidence to suggest that the risks are greater than previously believed.

18. These key messages and the more detailed evidence that the project has uncovered will feed into all future LSB work.

(ii) Note the research report commissioned from Economic Insight (Annex A) and the working draft of the in-house mapping report (Annex B), both of which we intend to publish in the next few months.

19. The key messages from these reports are highlighted above. In line with LSB policy of publishing all research reports and in order for this work to contribute to improved understanding across the market, we will publish both reports in the coming months.

(iii) Note the rationale for not pursuing further consideration of extending consumer protection to unregulated providers in 2016/17.

20. In March 2016 the Board approved the 2016/17 business plan, which provides for no further consideration of extending consumer protection to unregulated providers. This was based on the emerging findings from the unregulated project, which are now set out in full in this paper.

21. There are two potential routes by which the LSB could have pursued consideration of extending consumer protection:

- through further investigating the establishment of a s.163 voluntary arrangement, or
- through undertaking fresh Schedule 6 investigations, concerning alteration of the list of reserved legal activities

22. Neither of these options will be pursued at this stage, as:

- establishing a s.163 voluntary arrangement would be practically unworkable, and
- the project has not uncovered significant new evidence of detriment, beyond what was considered through the 2012-13 will writing investigation, which suggests an immediate need for a fresh Schedule 6 investigation.

### *Voluntary arrangements*

23. Our analysis of voluntary arrangements under section 163 suggests that this option would be practically unworkable for the following reasons:

- Discussion with those who have established voluntary oversight schemes suggests that they are resource intensive to establish and operate, which

means that a high level of demand is required in order to bring in sufficient fees to cover the costs.

- There is a limited potential market for voluntary regulation. The overall level of for profit unregulated provision is modest and there are a small number of existing voluntary bodies who could come under an arrangement. Existing voluntary bodies and unregulated providers that were involved in our research demonstrated little interest in an LSB voluntary arrangement (or any extension of statutory regulation).

24. In the light of the above, it would not be appropriate to devote LSB resources to investigating this further, as there would be no reasonable prospect of being able to recover the costs.

25. In this regard it is worth noting that two recent developments have provided the potential for additional oversight of unregulated providers, without LSB involvement. The SRA's recent rule change to allow them to authorise entities that do not intend to provide reserved legal activities provides an option for unregulated providers to come under the SRA's oversight if they wish. In addition, the Professional Paralegals Register (PPR) was launched in December 2015. This has the potential to consolidate some of the existing voluntary regulators under an oversight framework. Interest and uptake of both of these options will be monitored.

*Schedule 6 investigation*

26. Beyond voluntary arrangements, the main route that the LSB could pursue to extend consumer protection would be to consider extending the existing list of reserved legal activities, under section 24 of the Act. Given the previous Lord Chancellor's rejection of our 2013 recommendation for will writing to become a reserved legal activity, and the continuing political drive to reduce regulation, it is likely that such an approach would need to be accompanied by consideration (under section 26) of whether any existing reserved legal activities should cease to be reserved (to mitigate any net increase in regulation). The LSB's work on legislative reform considers the future of the reserved activities.

27. [REDACTED]



*Watching brief*

28. Instead of further project-based work during 2016/17, this project will be followed up through a watching brief.
29. The decision for the LSB not to pursue extension of consumer protection does not mean that we would not work with LeO if it were to develop its thoughts on creating a voluntary jurisdiction for unregulated providers. Such work would be undertaken through the watching brief, if required. It is noteworthy that there is no explicit mention of pursuing a voluntary jurisdiction in LeO's draft business plan for 2016/17.
30. It is possible that the output from the CMA's market study will strengthen the case for undertaking further investigations under Schedule 6. In fact, the CMA is one of the bodies that can directly request that we undertake a Schedule 6 investigation. Alternatively, the LSB could itself decide that the outputs from the CMA study, when combined with our existing evidence base, suggest the need for an investigation. This will need to be considered when the outputs from the CMA study are available.

**Next steps**

31. A communications plan and press lines will be developed to accompany publication of the mapping report and Economic Insight's research. These will be published together in the next few months, after ILN 2015 has been published.
32. The communications around publication will explain that the Board does not believe that we should pursue further consideration of extending consumer protection to unregulated providers at this stage.
33. Following publication the project would close and this workstream would be followed up through a watching brief.
34. The findings from this project are relevant to the legislative reform workstream, as it highlights the differences between regulated and unregulated providers and the potentially confusing boundaries between them. It also provides insights into the risks of different legal activities and thus whether these should attract regulation.

13.04.16